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ABSTRACT

This report provides findings of fact on the development of the Belmont Learning Complex of the Los Angeles Unified School District (LAUSD), and contains recommendations to remedy identified deficiencies in the LAUSD's current policies and procedures for siting and developing school buildings. The report addresses the following issues: (1) all contracts and payments to outside consultants and attorneys involved with Belmont; and (2) any account(s) controlled by the former Bond and Asset Management/Planning and Development offices. Principle findings reveal the LAUSD Board of Education and senior staff did not place sufficient priority on financial management from 1995 to 1999; that the Office of Planning and Development Personnel failed the LAUSD on Belmont; and that the contractors, consultants, and LAUSD staff failed to provide proper oversight of expenditures by the developer, contractor, and subcontractors. A list of the report's 72 exhibits is included. (GR)

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INTERNAL AUDIT AND SPECIAL INVESTIGATIONS UNIT

REPORT OF FINDINGS – PART II

LOS ANGELES UNIFIED SCHOOL DISTRICT • BOARD OF EDUCATION •

U.S. DEPARTMENT OF EDUCATION
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INTERNAL AUDIT AND SPECIAL INVESTIGATIONS UNIT

REPORT OF FINDINGS – PART II

LOS ANGELES UNIFIED SCHOOL DISTRICT • BOARD OF EDUCATION •

BELMONT LEARNING COMPLEX

Submitted by
Don Mullinax, Director

OSI 99-20 **DECEMBER 13, 1999**

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December 14, 1999

BY HAND DELIVERY

Members of the School Board
Los Angeles Unified School District
450 North Grand Avenue
Los Angeles, California 90012

Dear Board Members:

This is our second report on the investigation of the Belmont Learning Complex ("Belmont"). The first report was provided to you on September 14, 1999. As did the first report, this report responds to a motion adopted by the Board of Education on February 23, 1999.

The report contains specific findings of fact regarding the financial management practices, procedures, and systems within the Los Angeles Unified School District and, more specifically, the Belmont project. The report also contains recommendations to remedy identified weaknesses. I look forward to discussing them with you.

Thank you for your confidence and support of this Office as we proceed with our work.

Sincerely,

Don Mullinax

Don Mullinax
Director

Attachments

ACKNOWLEDGEMENTS

The Internal Auditor would like to acknowledge the thorough and capable assistance of his own staff, as well as the work of the firms and their employees who assisted in the preparation of this *Report of Findings – Part II*:

Internal Audit And Special Investigations Unit

Janis Eiler, chief investigator, Pete Roble, senior auditor, Norma Valenciano, senior auditor, Conrad Dungca, senior auditor, Uly Peregrino, senior auditor, and Roger Datu, senior auditor.

Preston Gates & Ellis LLP

From the Los Angeles office of this firm: attorneys Roger Lane Carrick, James K. Kawahara, and David B. Sadwick; law clerk Christa Alejo; legal assistants Beto Chavez, Lee Paige, Jack Schatz, and Gabriel Jurado; and legal secretaries Kim Burgo and Lorraine Velazquez.

Investigators And Consultants

Wayne Owens, investigator, Owens & Associates Investigations; Norman I. Wight, investigator, Darwin D. Wisdom, investigator and forensic specialist, Wisdom, Wight and Associates; Mike Walt, Orswell/Walt & Associates; and Ralph Summerford, Certified Public Accountant, Lisa Robbins, Senior Investigative Accountant, Kelly Todd, Certified Public Accountant, Summerford Accountancy, P.C., Certified Public Accountants & Fraud Examiners.

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EXECUTIVE SUMMARY

Belmont Learning Complex
Report Of Findings – Part II

The Internal Auditor issued his first report on the Belmont Learning Complex on September 14, 1999. In his transmittal letter to that *Report of Findings*, the Internal Auditor noted that he would submit a second report on the two remaining issues enumerated for his investigation by the Los Angeles Unified School District's ("LAUSD") Board of Education directive of February 23, 1999:

- All contracts and payments to outside consultants and attorneys involved with Belmont.
- Any account(s) controlled by the former Bond and Asset Management/Planning and Development offices.

This *Belmont Report of Findings – Part II* addresses the financial implications of Belmont, including a review of LAUSD's budgeting and accounting systems as applied to the Belmont situation. This *Belmont Report of Findings – Part II* completes the Internal Auditor's response to the Board of Education's February 23, 1999, directive. The highlights of the Findings in this *Belmont Report of Findings – Part II*, detailed below, include the following:

- The 1995-1997 and 1997-1999 LAUSD School Boards, Superintendents, Chief Administrative Officer, Chief Financial Officers, and Director of the Office of Planning and Development collectively did not place sufficient priority on financial management and did not ensure that (1) an actual budget for Belmont, including environmental financial contingencies was developed; (2) the budget was integrated into the overall LAUSD accounting structure; and (3) actual Belmont expenditures were properly supervised.

- O'Melveny & Myers LLP, Ernst & Young LLP, Hanscomb, Inc., and the Daniel, Mann, Johnson & Mendenhall firm breached their respective professional duties of care to the LAUSD with regard to financial matters in their various contracts with the LAUSD.

- Individual LAUSD employees Dominic Shambra, Raymond Rodriguez, Elizabeth Louargand and Rodger Friermuth failed to assure the accuracy and appropriateness of invoices presented to the LAUSD for payment of Belmont expenditures, in a manner resulting in actual overbilling of LAUSD by certain consultants and sub-contractors.

- Temple Beaudry Partners, Hanscomb, Inc., the Daniel, Mann, Johnson & Mendenhall firm, Raymond Rodriguez, Elizabeth Louargand and Rodger Friermuth, each failed to discover that Belmont sub-contractors Winegardner Masonry, Rucker Tile, Keenan, Hopkins, S&S, BMP Group, Queen City Glass, and Downey Electric each submitted repayment requests to LAUSD in which each company knew or should have known the company was overbilling the LAUSD. These overbillings collectively totaled $2,080,148.

I. FINDINGS

A. LAUSD Board Of Education And Senior Staff Did Not Place Sufficient Priority On Financial Management From 1995 To 1999.

1. The 1995-1997 And 1997-1999 LAUSD School Boards Did Not Place Sufficient Priority On Financial Management.

The former LAUSD School Boards (particularly the 1995-1997 and 1997-1999 School Boards) did not place sufficient priority on the LAUSD financial management systems. Notwithstanding that the period from 1995 to 1999 was a time of relative increases in budget dollars available to the LAUSD, these School Boards did not invest in the necessary enhancements to the Integrated Financial System to make that system responsive and adequate to the LAUSD's needs to keep reliable, transparent and auditable accounting records.

The former LAUSD School Boards (particularly the 1995-1997 and 1997-1999 School Boards) also did not take sufficient steps to ensure that LAUSD staff (1) required and supervised an actual budget for Belmont, including environmental financial contingencies; (2) integrated that budget into the overall LAUSD accounting structure; and (3) supervised actual Belmont expenditures.

2. The Former And Current LAUSD Superintendents Did Not Place Sufficient Priority On Financial Management.

Sidney A. Thompson, LAUSD Superintendent through the summer of 1997, and Dr. Ruben Zacarias, the current Superintendent, did not place sufficient priority of the LAUSD financial management systems. Notwithstanding that the period from 1995 to 1999 was a time of relative increases in budget dollars available to the LAUSD, these Superintendents did not act upon the requests of their respective Chief Financial Officers to invest in the necessary enhancements to the Integrated Financial System to make that system responsive and adequate to the LAUSD's needs to keep reliable, transparent and auditable accounting records.

Mr. Thompson and Dr. Zacarias also did not take sufficient steps to ensure that LAUSD staff (1) required and supervised an actual budget for Belmont, including environmental financial contingencies; (2) integrated that budget into the overall LAUSD accounting structure; and (3) supervised actual Belmont expenditures.

3. The Former Chief Administrative Officer Did Not Supervise The LAUSD In A Manner That Created A Reliable Financial Management System.

The former Chief Administrative Officer, Mr. David Koch, did not exercise sufficiently diligent supervision of the LAUSD financial management systems. Notwithstanding that the period from 1995 to 1999 was a time of relative increases in budget dollars available to the LAUSD, Mr. Koch did not act upon the requests of their respective Chief Financial Officers to invest in the necessary enhancements to the Integrated Financial System to make that system responsive and adequate to the LAUSD's needs to keep reliable, transparent and auditable accounting records.

Mr. Koch also did not exercise sufficiently diligent supervision of the LAUSD in (1) requiring and supervising an actual budget for Belmont, including environmental financial contingencies; (2) integrating that budget into the overall LAUSD accounting structure; and (3) supervising actual Belmont expenditures. In particular, the estimate of expenditures prepared by Mr. Koch in July 1999, though stating that the estimates were only preliminary, nonetheless omitted any estimate of environmental expenditures at Belmont. In fact, Belmont-related environmental expenditures stood in excess of $7 million at that time.

4. The Former And Current Chief Financial Officers Have Not Created Or Maintained A Reliable Financial Management System, And Did Not Exercise Diligent Supervision Of The LAUSD Financial Management Systems.

Henry Jones, the former Chief Financial Officer, and Olonzo Woodfin, the current Chief Financial Officer, did not, in their own opinions, maintain reliable financial management systems. While they both attempted to obtain the necessary financial resources to reform the situation, including funds to upgrade the automated Integrated Financial System, the actual functioning of the various financial accounting systems, both automated and manual, did not (individually and collectively) conform at all times with generally accepted public school accounting standards. The current Chief Financial Officer's good faith yet difficult efforts to answer the basic question of "what has the LAUSD spent on Belmont to date" is dramatic proof of the failure of these financial information systems, which upon auditing by the Internal Auditor's team cannot even confirm the accuracy of the Chief Financial Officer's good faith estimates.

B. The Office Of Planning And Development Personnel Failed The LAUSD On Belmont.

1. Mr. Dominic Shambra, Former Director Of The LAUSD's Office Of Planning And Development, Failed To Exercise Diligent Supervision Over Belmont Budgeting And Expenditures.

Mr. Dominic Shambra, while Director of the LAUSD's Office of Planning and Development, failed to supervise the outside consultants and further failed to prepare the proper records to permit the LAUSD to maintain generally accepted accounting records on the expenditures of his Office. His behavior raises questions of whether there were payments made for work not performed by certain of these outside consultants, including Mr. Wayne Wedin and Dr. Betty Hanson. While Mr. Shambra admitted and disclosed to the LAUSD General Counsel that he had developed, during the course of her employment with the LAUSD, a personal relationship with Dr. Betty Hanson, their respective positions of supervisor and subordinate raise the appearance of a conflict of interest, notwithstanding the General Counsel's apparent oral statements to Mr. Shambra that no actual conflict existed. In concert with an apparent overpayment of $11,325 to Dr. Hanson's employer, coupled with Mr. Wedin's failure to submit required annual reports and remarkable ability to work on holidays, Mr. Shambra appears to have failed to exercise the proper fiduciary responsibility he owed the LAUSD in his supervision of his Office.

Mr. Shambra also failed to exercise the proper fiduciary responsibility he owed the LAUSD in his supervision of his Office by (1) failing to develop an informed environmental contingency budget; (2) failing to require an environmental contingency element either in the Disposition and Development Agreement or on the LAUSD's own books; and (3) failing to establish a basis on which to seek reimbursement from state and/or local bond funds.

The Internal Auditor has probable cause to believe that Mr. Shambra must bear the ultimate responsibility as the senior LAUSD official directly responsible for the current Belmont situation. Notwithstanding the poor performance of his developmental, educational, legal and financial consultants, or the poor execution by his own supervisors (including the Board of Education) of their own oversight responsibilities, everyone contacted by the Internal Auditor's team inside and outside of the LAUSD looked to Mr. Shambra to guide the Belmont project to success. The Internal Auditor believes that Mr. Shambra failed the children, staff and taxpayers of the LAUSD with regard to his performance on Belmont. In light of that failure, LAUSD must take steps to prevent another Belmont from ever happening again, lest the potential for waste, fraud and abuse overtake the ability of the LAUSD to prevent it.

2. Mr. Raymond Rodriguez, Former Senior Member Of The LAUSD's Office Of Planning And Development, Failed To Exercise Diligent Supervision Over Belmont Budgeting And Expenditures.

Mr. Raymond Rodriguez, as the senior employee after Dominic Shambra in the LAUSD's Office of Planning and Development, failed to coordinate that Office's activities, including the activities of the outside consultants. Mr. Rodriguez further failed to prepare the proper records to permit the LAUSD to maintain generally accepted accounting records on the expenditures of that Office. His behavior raises questions of whether there were payments made for work not performed by certain of these outside consultants, including Mr. Wayne Wedin and Dr. Betty Hanson.

Mr. Rodriguez also failed to exercise the proper fiduciary responsibility he owed the LAUSD in his coordination of this Office's activities by (1) failing to develop an informed environmental contingency budget; (2) failing to require an environmental contingency element either in the Disposition and Development Agreement or on the LAUSD's own books; and (3) failing to establish a basis on which to seek reimbursement from state and/or local bond funds.

3. Dr. Betty Hanson And California Financial Services Overbilled The LAUSD

The Internal Auditor has probable cause to believe that Dr. Betty Hanson and/or California Financial Services, Inc., overbilled the LAUSD for $11,325.

4. Mr. Wayne Wedin Failed To Document His LAUSD Work Properly

The Internal Auditor has probable cause to believe that Mr. Wayne Wedin, while a consultant to the Office of Planning and Development, failed to provide required reports, both by activity and on an annual basis, as required by the LAUSD. Further, Mr. Wedin did not describe his work sufficiently to justify the payments he received from LAUSD, though they were approved for payment by Mr. Dominic Shambra.

5. Ernst & Young Breached Its Duty Of Professional Care To LAUSD

The Internal Auditor has probable cause to believe that Ernst & Young, though employed by and relied upon by the LAUSD as an expert, especially by the Office of Planning and Development, failed to identify or recommend financial risk avoidance strategies or other corrective action regarding the financial implications of the environmental remediation issue (whether by way of contingent reserve through the Development and Disposition Agreement or by way of a contingent reserve in LAUSD's own budget, or through the use of environmental insurance), thus failing to meet its professional responsibility to the LAUSD. To the extent that LAUSD personnel and consultants such as Mr. Shambra, Mr. Wedin and Dr. Hanson relied upon Ernst & Young, that firm failed to provide complete and thorough advice on matters within its competence and actual knowledge.

The Internal Auditor has probable cause to believe that Ernst & Young -- acting in that same time period as the LAUSD audit firm, accountant of record on the LAUSD financial statements used to issue the 1997 Certificates of Participation, and outside real estate financial expert to Mr. Shambra -- knew or should have known that Belmont's environmental situation posed a clear and present danger to the viability of the economic arrangements contemplated and pursued by the LAUSD to pay for Belmont.

C. Contractors, Consultants, And LAUSD Staff Failed To Provide Proper Oversight Of Expenditures By The Developer, Contractor, And Subcontractors.

1. O'Melveny & Myers LLP Breached Its Duty Of Professional Care To LAUSD.

Mr. David Cartwright, as a partner in the law firm of O'Melveny & Myers LLP, by written memorandum dated December 9, 1998, advised the LAUSD to relax its normal accounting procedures in tracking the expenditures by the developer, contractor and sub-contractors at Belmont. This remarkably ill-conceived advice prompted the Facilities Services Division to unwisely reduce their vigilance in assuring that all costs presented to the LAUSD for payment by the developer, contractor and sub-contractors were proper, accurate and lawful. This advice was relied upon by LAUSD, a fact known to Mr. Cartwright, who knew or should have known that such advice, if relied upon by LAUSD, constituted an invitation to potential waste, fraud and abuse, in a manner ultimately resulting in actual overbilling of LAUSD by certain sub-contractors.

2. The Firms Of Hanscomb, Inc. And Daniel, Mann, Johnson & Mendenhall Failed To Execute Their Duties Faithfully To Protect The LAUSD From Overbilling.

Hanscomb, Inc., and the Daniel, Mann, Johnson & Mendenhall firm were employed expressly by LAUSD to monitor the accuracy and appropriateness of work and expenditures at Belmont, yet they each failed to execute their respective contractual and professional duties to advise LAUSD faithfully on the accuracy and appropriateness of invoices presented to the LAUSD for payment of Belmont expenditures, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

3. Raymond Rodriguez, Elizabeth Louargand And Rodger Friermuth Failed To Execute Their Duties Faithfully To Protect The LAUSD From Overbilling.

In his role at the Office of Planning and Development, Mr. Raymond Rodriguez failed to perform or to cause Hanscomb, Inc., and the Daniel, Mann, Johnson & Mendenhall firm to perform, a review as to the accuracy and appropriateness of invoices presented to the LAUSD for payment of Belmont expenditures, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

In their respective roles in the Facilities Services Division, Ms. Elizabeth Louargand and Rodger Friermuth failed to perform individually or collectively, or individually or collectively to supervise Hanscomb, Inc., and the Daniel, Mann, Johnson & Mendenhall firm to perform, a review as to the accuracy and appropriateness of invoices presented to the LAUSD for payment of Belmont expenditures, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

4 Temple Beaudry Partners Failed To Execute Their Duties Faithfully To Protect The LAUSD From Overbilling.

Temple Beaudry Partners failed to execute their contractual duties under the Disposition and Development Agreement to review invoices, presented to the Temple Beaudry Partners and then forwarded to LAUSD for payment of Belmont expenditures, as to their accuracy and appropriateness, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

5. Winegardner Masonry; Rucker Tile; Keenan, Hopkins, S&S; BMP Group; Queen City Glass; and Downey Electric Overbilled The LAUSD For Their Work At Belmont, Implicating The California False Claims Act.

Sub-contractors Winegardner Masonry, Rucker Tile, Keenan, Hopkins, S&S, BMP Group, Queen City Glass, and Downey Electric each submitted repayment requests to LAUSD in which each company knew or should have known the company was overbilling the LAUSD. These overbillings collectively totaled $2,080,148.

II. RECOMMENDATIONS

A. Implement The Recommendations Of The Arthur Andersen, KPMG And Fuller Reports.

The School District should implement the recommendations in the KPMG and Fuller Reports immediately. With regard to the recommendations of fully implementing the Integrated Financial System (IFS), the Superintendent, Chief Operating officer, and Chief Financial Officer should conduct a cost-benefit analysis along with a market survey to determine if it is feasible to continue with this system. Since the inception of the IFS, other technologies and systems have evolved in the public and private sectors, including off-the-shelf accounting systems, which may be modified for LAUSD needs.

The difficulty of making informed decisions is increased when complete and reliable information on LAUSD programs and activities is unavailable. It is also difficult to make fully informed budget decisions when information on actual costs for programs is incorrect or unknown.

Without reliable financial information, LAUSD Board Members do not have the full facts necessary to make investments of scarce resources or direct programs. The lack of reliable financial information also impairs the School Board's ability to adequately fulfill another fundamental obligation to taxpayers – holding LAUSD managers accountable for the way they run LAUSD programs.

B. Encourage A Culture Of Excellence By Tightening LAUSD Accounting Policies And Procedures.

1. Promote A Culture Of Excellence Through Teamwork, Open Communications, And Sharing Of Information.

As disclosed in the first *Report of Findings*, the Internal Auditor again found various LAUSD offices and staff members who practiced a culture of "protect your turf, avoid accountability, and resist change." LAUSD must work every day to change its culture to one of excellence through teamwork, open communications and sharing of information.

2. Make Financial Management A LAUSD-Wide Priority.

Currently, LAUSD's financial data are not always useful, relevant, timely, and reliable enough to use for decision-making. Top management must be totally committed, in both words and actions, to making financial management improvement a LAUSD-wide priority. This commitment includes building a foundation of control and accountability that supports external reporting and performance management, providing clear and strong executive leadership, and using training to change the organizational culture and engage line managers. With existing advances in information technology, the LAUSD's finance function needs to shift from a paper-driven, labor intensive, clerical role to a more consultant-like role as advisor, strategist, analyst, and business partner. LAUSD needs to establish an expectation that the Chief Financial Officer is part of the top management team who provides forward looking analysis that creates a link between accounting information and budget formulation, therby contributing to strategic planning and decision-making.

3. Reconcile Direct Payments To All Outstanding Encumbrances.

The process of using Direct Payments must be reconciled to an outstanding encumbrance to avoid potential waste, fraud and abuse. Direct Payments should be supervised very tightly and used infrequently.

4. Review Invoices Submitted By Contractors and Vendors To Determine If They Have Overbilled LAUSD.

It almost goes without saying that LAUSD should use the strictest of review procedures to review Belmont invoices as they are submitted by any contractor or vendor to determine the accuracy and appropriateness of that invoice prior to payment. Existing checks and balances can be effective if they are followed in the most rigorous manner possible.

5. Investigate All Payments Made To Miscellaneous Vendor Codes.

Miscellaneous vendor codes are a necessary part of any accounting system, but they are a prime opportunity for those with a motive to engage in waste, fraud and abuse. All payments to miscellaneous vendor codes above a threshold amount should automatically be screened carefully for accuracy and appropriateness, and reconciled to an appropriate and applicable budget encumbrance. Miscellaneous vendor codes should never be used in lieu of regular contract code requirements without a clear, written rationale.

C. Hold LAUSD Employees Accountable For Their Performance.

1. Olonzo Woodfin.

The facts as set forth in this *Belmont Report of Findings – Part II*, including Mr. Woodfin's lack of aggressive actions to improve the School LAUSD's financial management practices, procedures and systems, should be considered in the context of his next scheduled performance evaluation.

2. Elizabeth Louargand And Rodger Friermuth.

The facts as set forth in this *Belmont Report of Findings – Part II*, including the failure of Ms. Louargand and Mr. Friermuth, individually and collectively, to supervise carefully the accuracy and appropriateness of actual Belmont expenditures, or to individually and collectively to supervise the outside consultants retained to review the accuracy and appropriateness of actual Belmont expenditures, should be addressed in their current disciplinary proceedings.

D. Revise Certain LAUSD Job Descriptions.

1. Revise The Class Description For Chief Financial Officer.

The LAUSD's Chief Financial Officer should be responsible for not only identifying funding sources and paying obligations, but should also be responsible for (i) managing and controlling LAUSD's financial resources by partnering with LAUSD offices, balancing LAUSD priorities, maintaining effective financial systems, providing reports and analysis, and issuing financial policy and guidance to ensure compliance with laws, statutes and regulations; (ii) assuring continuity of operations by providing accounting, disbursement, asset management, and other quality service to customers; and (iii) providing timely, accurate, consistent, and relevant full-cost executive information for assessing budgetary integrity, operating performance, stewardship, and internal controls which are essential in planning and performing the School LAUSD's mission economically, efficiently, and effectively.

2. Create A Senior Management Position Of "Chief Information Officer."

A Chief Information Officer is critical to building a LAUSD-wide information management capability. A Chief Information Officer serves as a bridge between top management, staff and information management support professionals. This includes focusing and advising senior management on high-value issues, decisions, and investments. Equally vital is taking a strong role in working with the staff to (i) design and manage a LAUSD-wide information technology architecture and (ii) clearly articulate how information management will play a pivotal role in mission improvement. Finally, the Chief Information Officer is usually accountable for serving staff with low-cost, high-quality information technology products and services. Over time, a successful Chief Information Officer evolves from serving only as head of the information management unit to becoming a strategic adviser and architect – a vital member of the top management team. The Chief Information Officer should report directly to the Superintendent.

E. Retain Legal Counsel And Investigate Whether A Civil Action May Be Pursued Against Ernst & Young LLP For Their Breach Of Professional Care Or Duty To The LAUSD.

The LAUSD should examine carefully the role of Ernst & Young with regard to their individual and collective roles, at the same time, of being (1) real estate financial advisor to the LAUSD's Office of Planning and Development; (2) auditor of the LAUSD's finances, and (3) accountant of record for the LAUSD's financial records as reflected in the 1997 Certificates of Participation used to finance Belmont. The Internal Auditor has probable cause to believe that in the first of these roles, Ernst & Young breached its professional duty of care to the LAUSD.

F. Commence Civil Legal Action Against The Law Firm Of O'Melveny & Myers LLP For Their Breach Of Professional Care Or Duty With Regard To Their Role At Belmont On The Issue Of Relaxing Financial Oversight Of The Belmont Developer, Contractor And Sub-Contractors, And Seek Damages And/Or Restitution To The LAUSD.

LAUSD should amend its existing action against O'Melveny & Myers consistent with the findings set forth in this *Belmont Report of Findings – Part II.*

G. Retain Legal Counsel And Investigate Whether A Civil Action May Be Pursued Against Hanscomb, Inc., For Breach Of Professional Care Or Duty With Regard To Their Role At Belmont.

LAUSD must definitively determine, consistent with the findings set forth in this Second Report, whether Hanscomb, Inc., breached its duty of professional care to the LAUSD.

H. Retain Legal Counsel And Investigate Whether A Civil Action May Be Pursued Against Daniel, Mann, Johnson & Mendenhall For Breach Of Professional Care Or Duty With Regard To Their Role At Belmont.

LAUSD must definitively determine, consistent with the findings set forth in this Second Report, whether Daniel, Mann, Johnson & Mendenhall breached its duty of professional care to the LAUSD.

I. Retain Legal Counsel And Commence Civil Legal Actions Against Winegardner Masonry; Rucker Tile; Keenan, Hopkins, S&S; BMP Group; Queen City Glass; And Downey Electric For Violations Of California's False Claims Act, Seeking Both Treble Damages And Civil Penalties.

LAUSD must discourage an atmosphere in which vendors to the LAUSD who have the opportunity and motive to commit waste, fraud or abuse on the LAUSD are able to evade detection, much less serious sanction. LAUSD should, following a complete audit of all payment requests submitted by the contractor and any sub-contractor at Belmont, seek enforcement to the fullest extent of the law against at least the following firms:

- Winegardner Masonry.
- Rucker Tile.
- Keenan, Hopkins, S&S.
- BMP Group.
- Queen City Glass.
- Downey Electric.

LAUSD should seek both treble damages for any overbillings from the inception of their work at Belmont, as well as civil penalties. The enumerated sub-contractors submitted payment requests which collectively totaled $2,080,148.

The Internal Auditor must, for the record, express his astonishment that these companies (and perhaps others), during the pendancy of this very investigation, and notwithstanding the extraordinary controversy surrounding Belmont, would attempt to overbill the LAUSD on Belmont construction. The LAUSD must strike swiftly and forcefully against these actions, for to fail to do so would endanger the LAUSD's financial health and embolden others to commit further waste, fraud and abuse.

J. Request That Dr. Betty Hanson And California Financial Services, Inc., Reimburse The LAUSD Or Provide Compelling Evidence As To Why Such A Reimbursement Is Not Required.

If this request is not handled in a manner satisfactory to the LAUSD, the LAUSD should commence civil legal action against Dr. Betty Hanson and California Financial Services, Inc., to collect the sum of $11,325.

K. Referrals To Prosecutorial Agencies

Based upon the facts available to the Internal Auditor, his attorneys and investigative team, either through documents or personal interviews, the Internal Auditor has probable cause to believe that certain acts or omissions by certain persons or entities may constitute violations of criminal law. As a result, the Internal Auditor has referred these matters to the Los Angeles County District Attorney and the California Attorney General for further investigation and determination, within the respective jurisdictions of those two prosecutorial offices, as to whether a criminal violation(s) has occurred. In light of the constitutional and statutory implications and protections required in criminal investigations, neither the Internal Auditor nor anyone on his legal and investigative teams will comment on any referral to a prosecutorial agency.

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A SPANISH TRANSLATION
OF THE EXECUTIVE SUMMARY IS
ATTACHED TO THE END OF THIS REPORT

CHAPTER 1

THE ROLE OF THE INTERNAL AUDITOR AND THE NATURE OF THE BELMONT INVESTIGATION

A. School Board's Authorizing Resolution

Following widespread public concerns regarding the manner in which the LAUSD selected, acquired and developed property for the Belmont Learning Complex ("Belmont"),[1] the LAUSD's Office of Internal Audit and Special Investigations Unit ("Internal Auditor") was directed by the LAUSD School Board ("School Board") on February 23, 1999,[2] to investigate the following six issues relating to Belmont:

1. The acquisition, environmental assessment, and remediation of all land associated with Belmont;
2. All contracts and payments to outside consultants and attorneys involved with Belmont;
3. Alleged existences of conflicts of interest relating to Belmont;
4. Any account(s) controlled by the former Bond and Asset Management/Planning and Development offices;
5. The selection, negotiation, and contracting process for the development and construction of Belmont; and
6. Pursue all legal rights and remedies including restitution in the event of the discovery of any wrongdoing regarding Belmont.

To assist the Internal Auditor in this investigation, the School Board also authorized funds by which the Internal Auditor retained investigators and outside counsel to assist in the Belmont investigation.[3]

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[1] The Internet websites for the *Daily News* and the *Los Angeles Times* can be accessed at **www.dailynews.com** and **www.latimes.com**, respectively, to obtain news articles relating to Belmont. "Belmont" will be used generally in this *Belmont Report of Findings – Part II* to describe the 35 acre site that now makes up the Belmont Learning Complex.

[2] Resolution of the Los Angeles Unified School District's Board of Education, dated February 23, 1999. *See* first *Report of Findings* Attachment 2.

[3] For Resumes of the Internal Auditor and his team see the first *Report of Findings* Attachment 1.

B. Purpose Of This *Belmont Report of Findings – Part II*

Pursuant to the School Board's six-point charge regarding Belmont, this *Belmont Report of Findings – Part II* addresses points 2, 4 and 6 set forth above. Proceeding according to recently enacted California Education Code §35401(c),[4] the Internal Auditor specifically deems this investigation and resulting *Belmont Report of Findings – Part II* necessary to serve the interests of the LAUSD. As a result, the Internal Auditor in this *Belmont Report of Findings – Part II* makes specific findings of fact regarding the financial accounting for the development and construction of the Belmont project and makes recommendations to remedy identified deficiencies in the LAUSD's current policies and procedures for the budgeting and accounting for the development and construction of school facilities, including payments to outside contractors, consultants and vendors as reflected in this review of Belmont.

The Internal Auditor issued the first *Report of Findings* on September 13, 1999, which primarily addressed environmental and conflict of interest issues in points 1, 3, 5 and 6. The Internal Auditor's *Belmont Report of Findings – Part II* is issued after making a review of all available contracts and payments to contractors, outside consultants and attorneys, as well as a review of the accounts controlled by the former Bond and Asset Management/Planning and Development Offices.

C. Scope And Methodology Of This *Belmont Report of Findings – Part II*

The scope of the Internal Auditor's inquiry has been retrospective in focus to investigate the payment history of certain Belmont project-related contracts, and to provide an assessment of the LAUSD's existing financial accounting systems based on the review of the Belmont project. The Internal Auditor was not directed to provide technical financial analysis regarding the decision to go forward with the Belmont project. Therefore, in this report the Internal Auditor has not undertaken a comprehensive financial analysis regarding the LAUSD's decision to complete the Belmont project.

During the review, the Internal Auditor and his staff were assisted by independent professionals, including the law firm of Preston Gates & Ellis LLP and a number of professional investigation firms, including Orswell/Walt and Associates, Owens & Associates Investigations, and Wisdom, Wight and Associates. The Internal Auditor also retained Summerford Accounting, P.C., to assist his team on financial accounting analysis, procedures and policy issues. This assembled team conducted the following tasks in carrying out the review of Belmont.

- Interviewed current and former personnel of the District's staff who were responsible for all aspects of the Belmont accounting.
- Interviewed personnel of the outside consultants who worked on Belmont.
- Requested and examined supporting documents, including original LAUSD correspondence, invoices, warrants, documents obtained from state agencies, and documents obtained from outside vendors and consultants who worked on Belmont.

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[4] SB 1260 (Hayden), Stats. 1999, c. 295 (signed by Governor Davis on August 31, 1999.)

- Requested and examined electronic data created on the LAUSD Integrated Financial System pertaining to the Belmont project.
- Performed a detailed review of more than 16,000 individual documents, including more than 260,000 pages.
- Performed reviews of other source or secondary materials as deemed necessary.

This review was conducted from September to December 1999. Documents cited in this *Belmont Report of Findings – Part II* are attached to this volume in both its hard copy and electronic versions.[5]

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[5] Documents deemed by the LAUSD to be (or contain) attorney/client privileged communications and/or attorney work product are shown as redacted wherever such redactions were required to protect these asserted privileges.

CHAPTER 2

SELECTED CALIFORNIA LAWS GOVERNING PUBLIC SCHOOL BUDGET & ACCOUNTING AND SCHOOL CONTRACTORS

A. The California Education Code

Under state law established in the California Education Code, the LAUSD is required to comply with specific requirements in regard to establishing procedures for their budget and accounting standards. The obligations of the LAUSD to ensure that it is in compliance with budgetary and accounting principles under the California Education Code are as follows:

1. Budget

LAUSD budgets are required to include a complete plan and statement of all proposed expenditures of the school district and of all estimated revenues for the following fiscal year, together with a comparison of revenues and expenditures for the existing fiscal year.[6]

On or before July 1st of each year the governing board of each school district shall hold a public hearing on the budget to be adopted for the subsequent fiscal year.[7] Not later than five days after a budget is adopted, the governing board is required to file that budget with the county superintendent of schools, in the Los Angeles County Office of Education.[8] The county superintendent of schools is required to either approve or disapprove the adopted budget for each school district on or before August 15th.[9] If the county superintendent of schools disapproves of the budget submitted by the school district, he or she must communicate to the governing board of the school district the disapproval along with recommendations for revisions to the budget, no later than August 15th.

The Internal Auditor understands that LAUSD's Superintendent submits to the LAUSD Board of Education early in the calendar year a proposed budget based in large part on the Govenor's proposed annual budget. The LAUSD Board of Education adopts a "Final Budget" by the end of June, though they typically adopt an "Adjusted Final Budget" following the final adoption (including gubernatorial budget vetoes) of the state's budget later in the summer or early fall.

The governing board of a school district that has its budget disapproved by the county superintendent shall adopt a revised budget and resubmit the revised budget to the county superintendent.[10] The county superintendent is required to approve or disapprove the revised budget.[11] If the county superintendent of schools disapproves the revised budget, he or she shall call for the formation of a budget review committee.[12]

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[6] *See* California Education Code § 42122

[7] *See* California Education Code § 42127 (a)(1)

[8] *See* California Education Code § 42127 (a)(2)

[9] *See* California Education Code § 42127 (d)

[10] *See* California Education Code § 42127 (e)

The budget review committee shall review the proposed budget of the district and transmit to the Superintendent of Public Instruction, the county superintendent of public schools, and the district governing board either a recommendation of approval or a report of disapproval for the school district budget.[13] The county superintendent of schools shall approve the school district budget if the budget review committee recommends approval.[14] If the budget review committee disapproves of the school district budget, the school district governing board shall send a response to the report of disapproval to the Superintendent of Public Instruction.[15] The Superintendent of Public Instruction shall then have the discretion to approve or disapprove of the school district budget. Pending budget approval, the school district shall continue to operate on the basis of the budget adopted by the governing board for the previous fiscal year or the unapproved budget for the current fiscal year depending on whichever contains a lower total spending authority.[16]

2. Deposit of Moneys

The LAUSD is required to deposit all moneys received or collected from any source and all moneys apportioned to it from taxes levied and collected under the authority of city councils for school purposes, into the county treasury to be placed to the proper fund of its district.[17] School district deposits, along with funds from other local agencies, make up a pool which the county treasurer manages for investment purposes.

3. Accounting

The accounting system used to record the financial affairs of the LAUSD must be in conducted in accordance with the definitions, instructions, and procedures published in the California School Accounting Manual ("Accounting Manual").[18] The Accounting Manual is approved by the State Board of Education and furnished by the Superintendent of Public Instruction.

The Accounting Manual describes various procedures for accounting for revenue and expenditures. Specifically, the manual explains in basic accounting terms, the accounting cycle, categories of funds, allowable funds, account groups, and budgetary accounts. Budgeting procedures are not addressed in the manual, except for a reservation made for future inclusion upon development of a budget development manual.

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[11] *See* California Education Code § 42127 (g)
[12] *See* California Education Code § 42127.1
[13] *See* California Education Code § 42127.2 (1)--(2)
[14] *See* California Education Code § 42127.3 (a)
[15] *See* California Education Code § 42127.3 (b)
[16] *See* California Education Code § 42127.4
[17] *See* California Education Code § 41001
[18] *See* California Education Code § 41010

In regard to certificates of participation ("COPs"), procedure number 606, contained in the Accounting Manual addresses accounting procedures for COPs. An issuance of COPs is a mechanism for providing capital to school districts and county offices to purchase equipment, finance construction projects, or refinance existing leases. The COPs financing technique provides long-term financing through a lease with an option to purchase or a conditional sales agreement. The major disadvantage of a COP is that there is no repayment source connected to its issuance.

Procedure numbers 203, 204 and 205 in the Accounting Manual address capital project funds accounting procedures. Capital project funds are established to account for financial resources to be used for the acquisition or construction of major capital facilities. The capital facilities fund is used primarily to account separately for moneys received from fees levied on developers or other agencies as a condition of approving development. The authority for these levies may be county or city ordinances or private agreements between the school district and the developer. [19]

The Accounting Manual does not provide guidance on every transaction that might occur in a school district. A notable omission in the Accounting Manual is the failure to provide budgeting procedures (see reserved procedure number 101).

Procedure numbers 701 and 702 provide guidance on classifying expenditures by program and distributing costs. The Accounting Manual provides that direct charges to the facilities program include:

- The costs of obtaining land and buildings through purchase, lease, rental or lease with option to purchase.
- Major remodeling.
- Construction of buildings and additions to buildings.
- Initial installation or extension of service systems and other built-in equipment.
- Initial improvements to sites.
- Books and equipment for new buildings.
- Salaries and other expenses of district employees assigned specifically to the facilities program.
- Architects, engineers, and contractors hired for capital improvement projects.
- Initial installation and extension of service systems and other built-in fixtures.

If problems are encountered which are not addressed in the Accounting Manual, the Governmental Accounting Standards Board's ("GASB") publication *Codification of Governmental Accounting and Financial Reporting Standards* should be consulted pursuant to the Accounting Manual. GASB establishes financial reporting and accounting requirements for state and local governments throughout the United States. Under GASB principles, governing bodies (such as state legislatures, city councils, or school boards) are required to submit annual reports. The annual reports show restrictions on the planned use of resources and measure the revenues and expenditures arising from certain activities. GASB's objective is to assist governing bodies in determining their compliance with finance-related laws, rules and regulations.

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[19] *See* California Government Code §§ 65970 - 65981

B. The California False Claims Act

Contractors and consultants who submit bids to officers of the LAUSD are subject to the California False Claims ActFalse Claims Act.

The False Claims Act was enacted in 1987.[20] The False Claims Act imposes liability on a person who knowingly presents or causes to be presented to an officer of the state or a political subdivision thereof a false claim (having a threshold value of $500 or more) for payment or approval.[21] The False Claims Act also imposes liability on a person who: (1) knowingly uses a false record or statement to get a false claim paid or approved; (2) conspires to defraud the state or subdivision by getting a false claim paid or approved; (3) knowingly delivers less property to a state or a subdivision; (5) knowingly buys or receives as a pledge or debt, public property from a person who may not sell or pledge the property; (6) knowingly makes, uses or causes to be made or used a false record or statement to conceal, avoid or decrease an obligation to pay or transmit money or property to the state or subdivision; or (7) is a beneficiary of an inadvertent submission of a false claim to the state or political subdivision, subsequently discovers the falsity of the claim, and fails to disclose the false claim to the state or political subdivision within a reasonable time after the discovery of the false claim.[22] A school district is covered as a political subdivision of the state.[23]

The False Claims Act states that "knowing" or "knowingly" means that a person, with respect to information, does any of the following: (1) has actual knowledge of the information; (2) acts in deliberate ignorance of the truth or falsity of the information; or (3) acts in reckless disregard of the truth or falsity of the information. The specific intent to defraud is not required.[24]

The False Claims Act imposes treble damages against a person or entity that violates the Act. In addition, even where no actual damages have been suffered by the public entity, the False Claims Act imposes civil penalties of up to $10,000 per each false claim.[25] Notwithstanding, the quasi-criminal nature of the available remedies, including treble damages and civil penalties, the burden of proof applicable to civil actions under the False Claims Act is preponderance of the evidence.[26]

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[20] The California Act was modeled after the Federal False Claims Act, 31 U.S.C. 3729-3732.

[21] *See* Govt. Code § 12651 (a)(1). The LAUSD is a political subdivision of the State.

[22] *See* Govt. Code § 12651 (a) (2)--(8)

[23] *See* Govt. Code § 12650 (c), which defines political subdivision to include, "any city, city and county, county, tax or assessment district, or other legally authorized local government entity with jurisdictional boundaries.

[24] *See* Govt. Code § 12650 (b)(2)

[25] *See* Govt. Code § 12651 (a)

[26] *See* Govt. Code § 12654 (c)

A civil action on behalf of a political subdivision shall be prosecuted by the prosecuting authority which includes, the local government official charged with investigating, filing, and conducting civil legal proceedings on behalf of, or in the name of, a particular subdivision.[27] Criminal liability may also attach to a False Claims Act violation.[28]

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[27] *See* Govt. Code § 12650 (b)(4)

[28] *See e.g.*, Govt. Code § 12654 (d)

CHAPTER 3

LAUSD'S INTERNAL PAYMENT SYSTEM

This chapter describes the LAUSD's system for the review and approval of payment applications made by consultants and contractors involved in the development and construction of the Belmont project. This chapter describes the following subjects: (1) LAUSD's organizational structure as it pertains to the payment approval process for Belmont-related contracts; (2) the review and payment process for construction contracts; and (3) the review and payment process for personal and professional service contracts.

The Internal Auditor received a briefing from LAUSD employees on October 11, 1999, on the internal accounting and financial control systems applicable to costs related to the development and construction of the Belmont project. This information, supplemented by further informal discussions and formal one-on-one interviews, along with other information developed during the course of this investigation, provide the basis for the following description of the LAUSD's internal payment system.

I. LAUSD – Organization For Financial Management

The Internal Auditor's review of the financial accounting and payment systems used to track and pay for the development and construction of the Belmont project primarily focused on the activities of LAUSD personnel, contractors and consultants to the LAUSD. In order to properly assess the responsibility for the accounting of the Belmont project, it is important to understand the organization of LAUSD for the period of 1997 to the present. 1997 is an important date because construction began in the Fall of 1997. The organizational charts for the LAUSD, for the Business Services Division and Facilities Services Division[29] for the period of 1990 to 1999 were attached to the first *Report of Findings* as Attachment 3 to that Report. The organizational charts for the Financial Division are attached to this *Belmont Report of Findings – Part II* as Exhibits 149. The following LAUSD offices and personnel were involved in the financial accounting and payment of costs for the development and construction of the Belmont project.

A. School Board

The LAUSD School Board is authorized by the California Education Code to act as the governing body in establishing overall policy and direction for the LAUSD.[30] In addition, the Education Code imposes specific obligations on the LAUSD Board in approving school budgets, and in committing public funds for school construction purposes.[31] As descibed more fully in the first *Report of Findings*, beginning in 1990, the LAUSD School Board took a number of official actions to approve the development and construction of the Belmont project.

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[29] The names of these Divisions have been changed periodically during the past nine years.

[30] California Education Code §5200.

[31] California Education Code §42100 and §42120.

B. Office Of The Superintendent

As described in the first *Report of Findings*, the chief executive officer of the LAUSD is the Superintendent, who establishes general management and oversight of all LAUSD personnel, operations, programs, buildings and funds. The Belmont site acquisition began in 1990 under Superintendent William Anton. Mr. Anton left the LAUSD in late 1992. At that time Mr. Sidney Thompson became Superintendent of the LAUSD. Mr. Thompson's superintendency extended during the majority of the time in which Belmont's land was acquired and planned for development. In describing his management style, Mr. Thompson has stated that he depended on a superintendent's cabinet consisting of the heads of the various divisions within LAUSD. At least ten units of LAUSD's professional staff reported directly to Mr. Thompson. Mr. Thompson retired from service to the LAUSD in July 1997.

Upon Mr. Thompson's retirement in 1997, Dr. Ruben Zacarias became Superintendent of the LAUSD. Prior to becoming superintendent, Dr. Zacarias served the LAUSD as the Deputy Superintendent from 1992 to 1997. Under an organizational change in the 1993-1994 school year, all Divisions of the LAUSD reported through the Deputy Superintendent's office to the Superintendent's office.

During the time of the development and construction of the Belmont project, the Superintendent's office had responsibility for managing and coordinating the activities of the LAUSD Divisions to ensure that project management and financial accounting responsibilities were carried out.

C. LAUSD Chief Financial Officer

The Chief Financial Officer is the responsible officer for all finance-related operations of the LAUSD. The Chief Financial Officer plans, organizes, assigns, directs and reviews the financial services functions of the LAUSD and participates in the planning and implementation of financial policies and programs. The primary responsibilities include preparation, implementation and financial reporting for all budgets, the development of financial planning for all revenues and expenditures of the LAUSD, monitoring financial performance, reporting financial results, and controlling the District's financial resources. The Chief Financial Officer also provides leadership, coordination and control of financial and related activities between the LAUSD and federal, state and city or other funding agencies.

The Chief Financial Officer has oversight responsibility for all operations related to budgeting and financial planning, accounting and financial reporting, payroll, disbursement of funds, collecting and investing funds, and borrowing funds through the issuance of debt instruments. The Chief Financial Officer must have the ability to analyze present problems, identify potential problems and develop and evaluate possible solutions.

From June 1994 to November 1998,[32] Mr. Henry Jones was the Chief Financial Officer of the LAUSD. Mr. Jones was employed in that position until November 1998, when Mr. Olonzo

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[32] Construction of the Belmont project began in 1997.

Woodfin was appointed as the acting LAUSD's Chief Financial Officer. Mr. Woodfin was appointed Chief Financial Officer in the Spring of 1999.

The Chief Financial Officer reports to the Chief Administrative Officer, who was David Koch at all times relevant to this *Belmont Report of Findings – Part II.*

D. Divisions

Outside of the Chief Financial Officer's staff, the first level of LAUSD's senior financial management is the Accounting and Disbursement Division. In addition, other LAUSD divisions with responsibility for Belmont development and construction costs include the following: Business Services Division, Facilities Services Division, and the General Counsel.[33]

- Accounting and Disbursement Division: Mr. Olonzo Woodfin served as controller and head of this Division from at least the 1996-1997 school year to the 1997-1998 school year. Ms. Yoshi Fong became acting controller during the 1998-1999 school year and is currently in that position.
- Business Services Division: During the period of 1990 to this year, Mr. David Koch was head of the Business Services Division;. first as Business Manager, or Division Administrator, Business Services, and later as the Chief Administrative Officer. In the Fall 1999, Mr. Howard Miller was retained as the Chief Operating Officer.
- Facilities Services Division: In the 1995-1996 school year, Ms. Elizabeth Louargand assumed the position of division head of the Facilities Services Division. Ms. Louargand served as head of the Facilities Services Division until May 1999. Ms. Lynn Roberts is currently head of the Facilities Services Division.
- General Counsel: The General Counsel's office was created in the 1994-1995 school year. Rich Mason assumed that position when it was created until the Fall of 1999. Mr. Richard Sheehan is currently employed as interim General Counsel to the LAUSD.

E. Branches

Following division heads, the next level of LAUSD Supervisory staff are branch heads. The following branch offices had key responsibilities for Belmont. Within the Facilities Services Division, the Project Management and Construction Branch had the responsibility for overseeing the construction of LAUSD school facilities.

- Project Management and Construction Branch: During the period of 1990 to 1999, the Design and Construction Branch functioned separately from the Real Estate Branch.[34] In the 1994-1995 school year, Janalyn Glymph became Director of the Facilities Planning & Analysis Branch, which was renamed the Project Management and Construction Branch the next year. Ms. Glymph was Director of the Project Management and Construction

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[33] The names of these Divisions have changed during the 1990 to 1999 period. Letter from Richard Mason to Bryan Steele, dated February 12, 1999. [IA-92142-158] *See* Exhibit 245 to the first *Report of Findings.*

[34] *See* Attachment 3 for LAUSD organization charts to the *First Report of Findings.*

Branch until the February 1999. Mr. Raymond Rodriquez has been the Director of the Project Management and Construction Branch for the period of February 1999 to September 1999. This function has now been renamed to the Construction Support Services Office.[35]

Within the Accounting and Disbursement Division, the Business Accounting Branch had the role of processing payments for the development and construction of the Belmont project. Within the Business Accounting Branch, the Accounts Payable Section and the Contract Unit within that section provide crucial accounting functions.

- Business Accounting Branch: During the 1996-1997 and 1997-1998 school years, Yoshi Fong was Director of Accounting and head of this Branch. In the 1998-1999 school year Mr. Fred Lising became the Director of Accounting and head of this Branch.
- Accounts Payable Section: Since the 1996-1997 school year, Mr. Howard Kaplowitz has been the Head Accountant within the Accounts Payable Section.

F. Office Of Planning And Development

As indicated in the first *Report of Findings*, the Office of Planning and Development was established by the LAUSD Board in the 1993-1994 school year and reported at all times directly to the Superintendent's office.[36] This Office of Planning and Development was established by the Superintendent to function outside the normal division and branch reporting relationships. The Superintendent and LAUSD School Board assigned Office of Planning and Development a variety of chores, including the general administrative management of Belmont through its development and pre-construction phases. Dominic Shambra was the first and only Director of the Office of Planning and Development. Mr. Shambra's statement to the Internal Auditor indicates that his overall project management responsibility for the Belmont project did not begin until August 1, 1994, when the LAUSD School Board formally approved the Belmont project concept.

Mr. Shambra reported to Superintendents Anton, Thompson and briefly to Superintendent Zacarias, who dissolved the Office of Planning and Development in the summer of 1997.[37] The LAUSD School Board also authorized the Office of Planning and Development to retain outside expertise in several areas, including financial, legal and project/development consulting.[38] According to his March 1997 job description, Mr. Shambra's responsibilities included the following:

- Serves as District representative to government agencies including the State Allocation Board, the Office of Public School Construction, the Community Redevelopment Agency and the state and federal departments of education.

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[35] Interview with Raymond Rodriquez, dated May 20, 1999.

[36] Interview with Sidney Thompson, dated August 9, 1999.

[37] Interviews with Dominic Shambra, dated March 29, 1999 and August 9, 1999.

[38] Interviews with Dominic Shambra, dated March 29, 1999 and August 9, 1999.

- Administers the budget for all funds generated by special agency agreements; resolves conflicts related to technical implementation of agreements; negotiates new agreements and implementation procedures in association with District and non-District legal counsel and the appropriate District divisions.
- Directs and monitors the activities of District architectural, financial, legal and negotiation consultants.
- Serves as a resource to the Superintendent, executive staff and Board of Education members; prepares and presents correspondence and reports regarding negotiations with government agencies and the private sector and information about potential public and/or political ramifications of District facility development activities.[39]

With regard to the scope of Mr. Shambra's authority and responsibility over the development of the Belmont project, it was made clear by Superintendent Anton and Superintendent Thompson that Mr. Shambra was assigned the lead management responsibility for Belmont, especially for the site acquisition and funding phases.[40] Mr. Shambra has informed the Internal Auditor that he acted as a project "coordinator" from August 1994 to February 1998. Mr. Shambra also informed the Internal Auditor that, prior to mid-1994, he was a member of the team assigned to acquire property generally for LAUSD.[41] The LAUSD School Board also designated Mr. Shambra as the authorized LAUSD representative to file applications for all new construction projects under the State School Facilities Act.[42] The Internal Auditor has received contradictory statements from the majority of LAUSD staff, who have stated that Mr. Shambra was the project executive for the Belmont project. The Office of Planning and Development was formally disbanded in July 1997 by Superintendent Ruben Zacarias. Mr. Shambra retired from the LAUSD in February of 1998.

II. LAUSD – Internal Payment System

A. The Payment Process For Temple Beaudry Partners

1. Payment Authorization:

There have been twenty-eight payment applications submitted by Temple Beaudry Partners for the construction costs at the Belmont project. The first payment to Temple Beaudry Partners was approved by Dominic Shambra, Director of the Planning and Development Office. No one in the Facilities Services Division reviewed this first payment. Thereafter, LAUSD staff and paid consultants reviewed payment applications from the developer. LAUSD hired two consultants to assist in the review of developer payment applications. The LAUSD's owner job site representative was Daniel, Mann, Johnson & Mendenhall, and LAUSD's consultant who was hired to review all developer payment applications for reasonableness and work completion was Hanscomb, Inc.

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[39] Attachment to Letter from Richard Mason to Bryan Steele, dated February 12, 1999. [IA-92142-158] *See* Exhibit 245 to the *First Report of Findings.*

[40] Interview with Sidney Thompson, dated August 9, 1999.

[41] Interviews with Dominic Shambra, dated March 29, 1999 and August 9, 1999.

[42] LAUSD Board Report No.2, February 1, 1993. [BL-00039-40] *See* Exhibit 247 to the *First Report of Findings.*

The LAUSD Facilities Services Division supervised the processing of Temple Beaudry Partners' payment requests nos. 2 through 9. Approximately two weeks prior to the end of the month, representatives of the contractor, developer and the LAUSD met to review the upcoming payment request. The stated purpose of this committee was to review anticipated subcontractor work and verify that the percentage of completion was accurate.

On or about the first of each month, payment requests were delivered to Mr. Paul Hurley of Daniel, Mann, Johnson & Mendenhall, who was the LAUSD's job site representative. Mr. Hurley of Daniel, Mann, Johnson & Mendenhall, along with the consultants from Hanscomb concurrently reviewed the payment requests for accuracy. The LAUSD's project manager, Rodger Friermuth, reviewed the payment requests to classify costs into six established programs. These programs were established to conform with State mandated categories (1025 -- sites, 1026 -- construction, 1027 -- tests, 1028 -- inspection, 1029 -- plans and 1030 -- furniture and equipment). Mr. Friermuth then sent the payment request to the LAUSD's Planning and Development Office. The Planning and Development Office reviewed the payment requests again, and then delivered them to the Accounts Payable Section.

The LAUSD Facilities Services Division also supervised the processing of Temple Beaudry Partners' payment requests nos. 10 through 25. Approximately two weeks prior to the end of the month, representatives of the contractor, developer and the LAUSD met to review the upcoming payment request. Again, the stated purpose of this committee was to review anticipated subcontractor work and verify that the percentage of completion was accurate. On or about the first of each month, payment requests were delivered to LAUSD project manager, Raymond Rodriquez. The LAUSD's project manager, Raymond Rodriquez reviewed the payment request and submitted them to the Accounts Payable Section for payment.

The LAUSD Facilities Services Division also supervised the processing of Temple Beaudry Partners' payment requests nos. 26 and 27. Approximately two weeks prior to the end of the month, representatives of the contractor, developer and the LAUSD met to review the upcoming payment request. Again, the stated purpose of this committee was to review anticipated subcontractor work and verify that the percentage of completion was accurate.

However, these two payment applications were delivered simultaneously to both Hanscomb and the Accounts Payable Section for simultaneous review to expedite payments. After approximately one week, the parties along with representatives from Turner/Kajima and Temple Beaudry Partners met to compare issues found in each respective review. A memorandum was prepared and faxed to Temple Beaudry Partners for corrective action, and a deadline for corrective action was established. If requested information or corrections were not provided by Temple Beaudry Partners, LAUSD would edit the payment application and process it for payment. Items edited out of the payment application would then be processed as a supplemental payment application if the requested information or corrections were provided.

Payment application no. 28 was processed under the supervision of the Facilities Services Division and the project director Edwin Weyrauch, with the assistance of the law firm of Weston Benshoof Rochefort Rubalcava MacCuish LLP. The results of this payment application are reported, in part, in Chapter 8.

2. Accounts Payable Section:

Once a Belmont payment is approved by the Facilities Services Division and the project manager, it is sent to the Accounts Payable Section, which follows the following procedures:

The Accounts Payable payer ("payer") examines the developer Temple Beaudry Partners' payment request package for content of contract forms and proper signatures affixed to the forms.

- The payer reviews the developer Temple Beaudry Partners' payment request (usually a spreadsheet) and checks all back-up documentation to assure agreement to the terms and conditions of the Disposition and Development Agreement contract as well as compliance with LAUSD procedures.
- The payer reviews Turner/Kajima's request for payment, which is submitted on a spread sheet (Form G703). The payer traces back-up documentation to assure agreement to the terms and conditions of the Disposition and Development Agreement contract as well as compliance with LAUSD procedures.
- Any questionable items in a billing are referred to the developer Temple Beaudry Partners and the Facilities Services Division. If requested responses and documentation are not provided, the questionable items are not paid. The particular amounts are subtracted from the billing and the remainder is paid.
- The payer approves and processes for payment that portion of the payment request that conforms with the terms and conditions of the Disposition and Development Agreement contract as well as compliance with LAUSD procedures. The payment request is transmitted electronically to the Los Angeles County Office of Education for review and warrant generation.
- Payment is posted to the vendor's payment record card, and supporting documentation is filed.
- After the warrant is received from the County, the Warrant Production Unit verifies the payee's name and address and the amount of the warrant, which are on warrant listings, against the payment supporting documents. This unit sends remittals and other documents that are attached to the warrant to the Job Cost Accounting Section, which retains the warrant until instructed to release it by the Warrant Production Unit.

3. County Of Los Angeles:

The Los Angeles County Office of Education audits any payments over $100,000, and all contracts upon receipt of a request for payment associated with a contract. Commercial warrants are issued by the Los Angeles County Office of Education to pay properly documented payments approved by LAUSD.

B. The Payment Process For Personal And Professional Service Contracts:

In the course of the development and construction of the Belmont project, the LAUSD employed the services of a number of consultants and professional services. The LAUSD has developed an internal document to provide guidance on personal and professional service contracts – the *Personal and Professional Services Contract Handbook*, Contract and Insurance Services Branch, September 1996 ("*Contract Handbook*"). According to the *Contract Handbook*, personal and professional service contracts may be used to engage the services of qualified individuals (independent contractors) to provide temporary special services in such areas as financial, economic, accounting, engineering, legal or administrative matters. *Contract Handbook*, page 1-2, Exhibit 9. The authority to negotiate and approve personal and professional service contracts is dispersed throughout the LAUSD organization at the branch level and above.

1. Office Of General Counsel:

O'Melveny & Myers LLP were the attorneys hired to provide advice and counsel to the LAUSD on the development and construction of the Belmont project. The LAUSD Office of General Counsel was established as of July 1, 1994. Prior to that time, O'Melveny & Myers' invoices were generally reviewed by Ron Apperson of the LAUSD's Legal Adviser's Office. O'Melveny & Myers invoices for land acquisition/real estate matters would involve eminent domain activity and real estate transactional activity. Eminent domain matters were supervised under the auspices of the Real Estate Branch, while the transactional activity (primarily David Cartwright of O'Melveny & Myers) was generally supervised under the auspices of Dominic Shambra in the Office of Planning and Development.

Legal bills were approved by either the Real Estate Branch or the Office of Planning and Development and submitted for review by the Office of General Counsel for processing. Administrative Assistants reviewed all charges for accuracy, and the General Counsel reviewed charges for appropriateness. Bills were then forwarded to the Real Estate Branch, which itemized the bills into various projects and then submitted them for payment to the Accounts Payable Section.

2. Office Of Planning And Development:

The Office of Planning and Development entered into a number of professional service contracts to retain consulting services related to the development and construction of the Belmont project. Dominic Shambra, who was director of the Office for the length of its existence was the "sponsor" for these contracts, including Ernst & Young LLP, O'Melveny & Myers LLP, Wedin Enterprises, and California Financial Services.

3. Environmental Health And Safety Branch:

The Environmental Health and Safety Branch was authorized to retain contractors for technical environmental assessment. Prior to approval, the Environmental Assessment Coordinator compares each invoice to work completed before approving and sending the invoice to the Principal Administrative Analyst. The Principal Administrative Analyst compares invoice rates to fee schedules and contract amounts before forwarding to the Document Processing Unit within the Accounts Payable Section.

4. Accounts Payable Section

Once invoices are approved by the contract sponsors, they are sent to the Accounts Payable Section. According to LAUSD procedures, the Accounts Payable Section must complete the following:

- Sort incoming mail by vendor - current or rush payment request.
- Verify that each invoice is supported by a purchase order or contract or board report. Indicate fund number and vendor code on invoices, amount, date and address.
- Verify that invoices are signed and approved by authorized district personnel.
- Verify the accuracy of the amount to be paid, address, name of payee. Scan the corresponding purchase order table into the Integrated Financial System.
- Review the contract and make sure invoices are in accordance with specifications of the contract. Attach all supporting documents needed for county approval.
- Enter the vendor invoice into the "system."
- Request additional/missing document from vendors and/or different department in the district. Periodic follow-up may be needed.

III. Internal Auditor's Comments On Payment System

As described more fully in Chapters 4 and 7, the Internal Auditor has reasonable cause to believe that individual LAUSD staff are unable to meet their financial accounting performance requirements because of antiquated financial information systems. Further system inadequacies have resulted in a breakdown in the checks and balances needed in a proper internal payment system.

CHAPTER 4

PRIOR REPORTS DOCUMENT BREAKDOWNS IN LAUSD'S BUDGETING, ACCOUNTING AND PROCUREMENT SYSTEMS

I. Why Are The Prior Analyses Of LAUSD's Budget And Accounting Procedures And Policies Important?

In preparing this Report, the Internal Auditor examined in particular three recent reviews of the LAUSD's budgeting, accounting and procurement procedures. The first, presented to the LAUSD on June 12, 1997, by the consulting firm of Arthur Andersen, focused on the organization of the LAUSD's Information Technology Division. The second, submitted to the LAUSD on June 11, 1999, was prepared by the accounting firm of KPMG. The third, and most comprehensive report, was prepared by Fuller Consulting, a division of L&L Fuller, Inc., and presented to LAUSD on September 30, 1999.

The importance for Belmont of these three reviews, which are discussed at length below, is simple – they describe the systemic problems and failures of the LAUSD budgeting, accounting and procurement systems. More dramatically, the Arthur Andersen report, coming in the summer of 1997, just as the LAUSD installed a new superintendent and Belmont began its final design and construction phase, starkly detailed the remarkably dysfunctional professional culture embodied by the Board and senior staff of the LAUSD. Based upon the Internal Auditor's investigation, things have changed only slightly.

The Internal Auditor's detailed analysis of Belmont must be seen as a dramatic illustration of the problems and failures laid out previously by these three consultants, each acting independently of one another. The Belmont experience is not, as most of the LAUSD staff would like to believe, atypical of the LAUSD experience. Rather, the whole LAUSD system is troubled, not just as it operated in relation to Belmont, but as it attempts to meet the challenges of day-to-day operations.

II. Arthur Andersen's 1997 Analysis[43]

This review is critical to understanding the LAUSD's financial accounting system, for the LAUSD (like most large, billion dollar entities) relies upon its automated processes for virtually all data entry, retention and analysis. Arthur Andersen's key findings in 1997 remain substantially accurate in late 1999, as confirmed during the Internal Auditor's investigation of the Belmont situation. Arthur Andersen's conclusions, while stark and chilling, especially in that they were made just as a new superintendent took over the LAUSD and the fundamental implementation of the Belmont construction effort began, remain accurate and on-point:

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[43] "Los Angeles Unified School District Information Technology Division Organizational Review," June 12, 1997, prepared by Arthur Andersen.

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> We would be remiss if we did not discuss our observations gained over the course of our three engagements at LAUSD. It is evident that organizational politics continue to play a prominent role in how decisions are made and work is performed within the District. Individuals and groups within the District appear to have the ability to politically influence District technology decisions oftentimes at the expense of the District's overall [Information Technology] needs.
>
> Years of political in-fighting have left their mark on the District. The miscommunication and mistrust among the District's senior management has resulted in a disparate and fractured organization. Further complicating matters is the District's apparent distaste or inability to hold individuals accountable for their performance, particularly at the senior management level. The combination of these two behaviors has nearly stopped the development and implementation of meaningful technology solutions within the District. Unfortunately, it is the students and other employees within the District that are most adversely affected by this situation.[44]

As a result of these findings, Arthur Andersen went on to make several significant recommendations, including the following:

> District productivity is hampered by political gamesmanship and the maneuverings of the Board, senior staff and their representatives. The lack of trust and respect among peers is through viewing their communications and looking at their actions towards each other. Congenial talk with limited real action and an abundance of protective memos seems to be the modus operandi. This environment is very inefficient and characterized by limited cross-functional collaboration between divisions. The Board, senior staff and divisions work most effectively together in crisis-type situations where they rally for the good of the District, temporarily setting aside their own priorities.[45]

III. The KPMG June 1999 Report[46]

The primary objective of this review was to provide an independent assessment of the policies, procedures, technology tools, and utilization of resources to provide recommendations for improving LAUSD's internal control structure and to identify potential operational efficiencies for improved effectiveness and cost savings. This report focused on an "operational and internal controls review" in order to provide LAUSD's management with recommendations for improving the following selected, procurement-related processes:

- Purchasing process.

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[44] Id., at 8.

[45] Id., at 13.

[46] The material set forth here is taken directly and substantially from the KPMG Executive Summary. See "Los Angeles Unified School District Limited Operational and Internal Controls Review of Select Procurement Activities," June 11, 1999, KPMG LLP, *passim*.

- Purchasing bid process.
- "A" and "B" letter procurement process.
- Real Estate and Asset Management contracting process.
- Environment Health and Safety Branch contracting process.
- Personal and professional services contracting process.
- BB Bond contracting process.
- Accounts payable process.

This review was focused on eight of LAUSD's procurement-related processes. For each process reviewed, several opportunities for improvement were identified. Based on the review and the nature of the individual findings in each of the processes, the following summarizes the common themes observed throughout this review.

A. Policies And Procedures

During their examination of the LAUSD's procurement-related processes, KPMG observed a general need for clear, updated policies and procedures. Current LAUSD procurement policies and procedures are comprised of LAUSD Bulletins and other documentation and may not always be reflective of actual procurement practices. In addition, many policies and procedures are several years old and do not reflect the changes associated with LAUSD's transition to the Integrated Financial System ("IFS").

KPMG recommended that LAUSD update its procurement policies and procedures into a comprehensive policies and procedures manual. These policies and procedures should be written to reflect the IFS system. Once drafted, such procedures must be communicated to, distributed to, and acknowledged by all appropriate personnel.

KPMG observed that developing and distributing new, comprehensive policies and procedures will not be enough, however. As noted above, procurement practice in schools and offices has not always conformed with published policy. In order for new policies and procedures to be useful, LAUSD staff involved in procurement-related activities should be held accountable. KPMG recommended that LAUSD require all employees to read and sign an acknowledgment of understanding of the policies and procedures manual (particularly the ethics section within the manual) with the understanding that violation of LAUSD procurement policy is grounds for disciplinary action. KPMG also endorsed the new plans of the LAUSD's Internal Audit and Special Investigations Unit to perform periodic operational audits of LAUSD purchasing and procurement activities to verify compliance with established LAUSD policies and procedures.

B. Information Technology

KPMG found that the LAUSD has not taken full advantage of the functionality offered by the Integrated Financial System. In fact, IFS has yet to be fully implemented in all LAUSD schools and offices -- five years after its initial roll-out. Full, effective implementation of IFS is also limited by the continued existence of several stand-alone software packages and duplicative manual processes utilized by LAUSD branches and divisions to track detailed information outside of IFS. Such practices unnecessarily duplicate data input, can inhibit reconciliation efforts, and make it difficult to obtain accurate, intelligible management reports from IFS.

The following steps, if taken, can enable the LAUSD to leverage its existing information system to dramatically increase the productivity and accuracy of its purchasing and contracting processes:

- Full implementation of IFS in all schools and offices.
- Use of standard document entry screens by schools rather than IFS table screens.
- Implementation of electronic approval paths to eliminate paperwork and enhance the controls over requisition, purchase order, and contract approval processes.

KPMG also learned that several types of LAUSD purchasing and procurement documents print centrally at the LAUSD's Information Technology Department ("ITD") each evening. These documents are distributed daily to the relevant department, warehouse, school, or office by ITD. KPMG recommended that IFS document printing be decentralized. Instead of printing documents at ITD, documents can be printed by the requesting location. This change will eliminate processing delays associated with the distribution of documents from ITD.

C. IFS Training

Many of the recommendations enumerated throughout KPMG's report require that the LAUSD perform additional IFS training for school/office staff. High turnover rates in school/office administrative staff present ongoing challenges for the LAUSD, because these staff need to be trained in the use of IFS. In addition, previous LAUSD training efforts have focused disproportionately on simplifying IFS data entry for end-users. As a result, the quality of purchasing and procurement data in the system may be compromised.

In order for their recommendations to take full effect, KPMG noted that the LAUSD will need to provide additional IFS training for school/office staff. Topics covered in this training course should include:

- Using detailed commodity codes (when to use them and which ones to use).
- Using IFS document processing.
- Using electronic approval for documents and/or commodities.
- Using the price agreement ("PG") document.
- Using the on-line receiver ("RC") document -- for school/office receiving staff.
- Using the stock return ("SN") document.
- Processing book/instructional material purchases in IFS.

A training program that includes these topics would better position school and office staff to enter complete, accurate procurement and purchasing data into IFS, thereby enabling generation of IFS management reports that more accurately reflect actual LAUSD purchasing and procurement patterns.

Along with the additional training courses mentioned above, KPMG recommended that the LAUSD consider developing and offering an ongoing, "IFS for LAUSD Newcomers" training course. This course should be offered as frequently as demand requires and be advertised to schools/offices. The LAUSD should direct its Human Resources Division to require newly hired staff whose job descriptions entail IFS usage to be scheduled into the next available "IFS for LAUSD Newcomers" training course. Consideration should be given to offering this during the summer or "down-time" for year-round school staff.

D. Resistance To Change

During interviews with all levels of LAUSD procurement and purchasing staff, it was frequently mentioned that changes in policy, procedure, or new process automation traditionally meet with a high degree of resistance throughout the organization.

In order to avoid the risks created by current procurement practices, KPMG recommended that the LAUSD implement available system functionality to strengthen internal controls. Current IFS data entry methods do not allow the LAUSD to monitor or comprehensively audit procurement patterns, thus exposing the LAUSD to fraud, waste, and abuse. For example, staff can submit after-the-fact confirmation purchase orders, a process that does not conform with commonly accepted procurement methodology and exposes the LAUSD to serious abuse.

Institution and enforcement of clear, updated procurement policies and procedures, in tandem with upgraded IFS training programs and better use of existing IFS functionality, will go a long way toward overcoming traditional resistance to change. With the recent appointment of a Chief Administrative Officer, KPMG observed that the LAUSD is better positioned than in the past to effect such change initiatives. This position has the potential to be the highly visible, institutionally strong champion of change necessary to effectively implement the recommendations posed in this report.

E. IFS Management Reporting

Another common observation made by LAUSD management team members associated with purchasing and procurement is that they are unable to obtain useful management reporting information from IFS. They cite two primary reasons for this shortcoming:

- The quality and detail-level of data being entered into IFS by school/office staff is inadequate and short-circuits any attempts at meaningful reporting.
- The desired reports are not readily available from IFS, and requests for new reports are realized in either an inadequately or untimely fashion.

KPMG observed that, if the recommendations pertaining to better use of the IFS system and IFS training are fully implemented, the quality, completeness, and accuracy of the data in the IFS system should rise markedly. If data is entered according to how IFS was designed to accept purchasing and procurement data, instead of what way is easiest to enter, the data available will be much easier to array in meaningful management reports. Higher detail, commodity-driven data entry will give the LAUSD the opportunity to use IFS reporting functionality to its fullest degree.

In order to satisfy the ongoing information needs of LAUSD purchasing and procurement managers, KPMG recommended that ITD convene forums with these key managers to determine what management reports they need from IFS. Once designed, these report formats should be stored so that managers can request these reports as necessary.

As if to underscore KPMG's findings, during the Internal Auditor's interviews of current and former LAUSD staff, these individuals were asked to comment on the adequacy of the (IFS) system. The following are a few examples of statements made by these individuals:

- IFS is incapable of producing reports that are required by state law, has flaws, and is not user friendly.
- The IFS, since its inception, was "one hell of a mess" which caused several systems of bookkeeping by various District entities in order to do the work.
- IFS does not allow reports needed by the Board, management, and state agencies.
- IFS is "terrible."

IV. The Fuller Consulting September 1999 Report[47]

Fuller observed that in July of 1997, Dr. Ruben Zacarias was appointed Superintendent of the LAUSD, and under his leadership, the LAUSD undertook a number of instructional and administrative initiatives, including steps to overhaul the LAUSD budgeting system. In the fall of 1998, at the request of Superintendent Zacarias and David W. Koch, the Chief Administrative Officer ("CAO"), Fuller Consulting conducted a diagnostic review of the budget policies and practices of the LAUSD to identify likely areas of weakness, their scope, and their current and potential impact on the LAUSD's management effectiveness. By far, the most significant finding of Fuller's diagnostic review was that, at the LAUSD, the budget drives policy rather than policy driving the budget. Fuller observed that, over time, the budget process evolved into the *de facto* principal decision-making process of the LAUSD. Many decisions of the LAUSD concerning priorities and major initiatives that would normally be expected to be made in a goal and objective-setting process or in strategic and operational planning processes are often made as part of the budgeting process.

Fuller set forth eight conclusions concerning the effectiveness and efficiency with which the LAUSD's budget planning, development and implementation processes are executed. Because the budget processes of the LAUSD are very complex and many elements have a relation to one or more of the other elements, a number of our conclusions and their supporting findings sometimes overlap. Fuller's eight conclusions were as follows:

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[47] The material set forth here is taken directly and substantially from the Fuller Report's Executive Summary. See "Enhancing the Budget Process of the Los Angeles Unified School District: An Operations Review, September 30, 1999 Final Report, Fuller Consulting, a division of L&L Fuller, Inc., *passim*.

> Conclusion #1 - The LAUSD's budget development process is not adequately supported by an overall strategic, operational or financial planning process.

Fuller found that most of the elements of a planning and control system are not fully in place in the LAUSD. As a result, the one essential process that is in-place, the budget process, became the LAUSD's dominant process, and one that drives policy rather than reflecting it. This is not a surprising situation in light of the absence of formal, institutionalized processes that would normally produce the policies and direction for the LAUSD.

Fuller observed that there is no formal strategic planning process, or comprehensive strategic plan, in-place in the LAUSD to provide a roadmap for budget development. The LAUSD currently has a variety of planning processes designed to respond to specific problems (e.g., the facilities plan, the reading plan, and the plan to respond to the needs of special education students). Traditionally, however, the LAUSD's planning processes have been fragmented and have not been integrated into a formal strategic plan, or into a long-range budget development process. Fuller concluded that the absence of an integrated strategic plan has left the LAUSD without a full vision or road map of the future, which, among other things, could provide budget-related direction.

Fuller also observed that LAUSD has no integrated annual operating planning process or operating plan. Heretofore, the LAUSD had no operating planning process nor an operating plan setting out the coming year's objectives and priorities. Fuller also observed, however, that over the last two years, a major effort has been made by the Superintendent and the LAUSD's senior managers to develop coordinated operating guidance for the LAUSD.

Fuller concluded that the LAUSD does not have an adequate budget planning process. Although the LAUSD has historically done an excellent job of meeting the various budget preparation deadlines to meld with the State of California's process, it manages to do so without an adequate budget planning process in-place. The actual and potential ill-effects of this are heightened by the fact that the LAUSD has not done an adequate job of documenting some of its key budget development and implementation-related policies and practices.

Fuller concluded that the LAUSD is substantially reactive to the State's budget process. Currently, the LAUSD waits until January when the Governor's Proposed Budget is released before it makes the first real estimate of what resources will be available to it in the coming fiscal year, which begins on July 1. In essence, the publication of the Governor's proposed budget begins the LAUSD's annual budget cycle, and each step thereafter is reactive to an action at the State level involving the Governor's budget. By waiting for the Governor's proposed budget before starting its cycle, the LAUSD severely limits the amount of time it has to plan and develop its own budget.

> Conclusion #2 - The LAUSD's budget planning and development cycle is too short to facilitate many of the analyses that should be conducted as part of the budget process.

The LAUSD's current active budget development cycle covers only a seven-month period from February to August. The LAUSD's short budget preparation window inhibits the ability of managers to adequately assess the resource needs of the myriad of programs and functions that constitute the complex operations of the LAUSD. Given the tremendous scope and size of the LAUSD's instructional and non-instructional operations, the institutions overall interests would be better served if it had a budget planning and development process that matched program and activity objectives and priorities with sufficient resources.

As a result of the short budget development time-frame, the LAUSD uses incremental budgeting to simplify budget development and to ensure that established deadlines are met. The starting point for next year's budget is this year's budget. The current budget is usually changed only incrementally, line item to line item, to reflect funding changes, changes in legal mandates, or inflationary and other formula-based factors.

The budget development process does not involve, to any significant degree, a variety of the LAUSD's stakeholders. Through possible inadvertence, the LAUSD has effectively excluded a number of key stakeholders from meaningful participation in the budget development process.

> Conclusion #3 - The LAUSD's account code structure does not permit it to adequately capture, organize and report financial data.

Fuller noted that the account codes utilized by the LAUSD are centered around funding sources rather than a hierarchy of functions, activities and programs. This is reflected in the LAUSD's budget which shows planned expenditures by the source of the funds. Expenditures are tracked against budget category and line item within the category. Simply put, if anyone wants to know how much is being spent for a particular purpose, the answer may not readily be available through the financial systems or staff.

Fuller recommended that senior management of the LAUSD be able to determine, within reasonable periods of time, both what has been allocated to a specific activity or program and what has been expended in support of the activity or program. This type of information is essential to tracking budget plan to budget actual throughout the year. It is also critical to assessing the effectiveness or efficiency of the activity or program. Finally, it is information that helps a manager decide whether or not some financial trade-offs will be required between two or more activities or programs because one is spending its budgeted funds faster than anticipated, or another is spending at a much slower rate. Activity or program financials are critical tools that are expected to be available to managers at all levels. The LAUSD's account code structure does not allow for data to be captured in this manner.

Fuller noted that while the LAUSD does a good job in accounting for what is bought, its account code structure does not allow for easy determinations of the purpose of costs. For example, the LAUSD's managers cannot readily determine costs in broad areas such as total instruction, total non-instruction or staff development. On a more specific basis, the LAUSD has difficulty capturing costs such as those for math, English or history at any given school-site. Specifically, the account codes utilized by the LAUSD are centered around funding sources rather than the hierarchy of functions, activities and programs.

Fuller found that the LAUSD currently has 6,509 account codes, of which 92 percent or 5,988, are active. The largest 200 of these codes account for approximately 96 percent of the LAUSD's annual expenditures. Given this, the balance of the LAUSD's appropriation codes (6,309) represent only four percent of the LAUSD's annual expenditures. For this reason, it is probable that some of the appropriation codes could be consolidated.

Although there are a large, perhaps even excessive number of account codes used by the LAUSD, the sheer number is not the primary problem. The primary problem is that the codes in use do not permit data to be collected and displayed in a manner of maximum usefulness to managers.

While the LAUSD's account code structure allows it to properly account for funding sources, location of expenditures, and the object of expenditure, it does little to account for the specific nature of how funds are expended and to what larger purpose. Much as the LAUSD lacks a strategic or operational plan to provide a blueprint for budget planners to properly allocate resources, the LAUSD's account code structure lacks the framework to depict and account for how funds are being spent and to tie them back to a specific function or operational goal.

The LAUSD's current account code structure will be impacted by the State's requirement for the new Standardized Account Code Structure ("SACS"). However, the new codes, alone, will not result in a complete account code structure that provides simple and easy to access financial data on a functional, activity or program basis. An enhanced account code structure beyond the requirements of the state's mandate will be needed to accomplish this.

> Conclusion #4 - Financial reports currently produced by the LAUSD are not useful tools for management.

Fuller found that the LAUSD produces more than 1,000 different, regularly scheduled and ad hoc financial reports generated via the Integrated Financial System. The production of these reports results in the annual distribution of approximately 10 million pages of financial information. The monthly financial reports, alone, sent to schools average 165 pages each. In other words, there is a plethora of available financial data. However, Fuller found that virtually all of the individuals receiving these reports found the reports to be cumbersome, incomprehensible, tardy and unreliable. Additionally, the LAUSD's financial reports are replete with acronyms and abbreviations (Fuller counted more than 500) that are not easily understood. In light of these factors it is not surprising that Fuller could not find any manager who said the IFS-generated reports were used regularly to make management decisions. Additionally, Fuller found that:

- Key executives of the LAUSD do not receive regular and routine financial reports.
- The LAUSD is unable to determine, with any degree of certainty, the number of reports it generates, and to whom they are distributed.
- IFS-generated reports are often untimely and inaccurate.
- IFS-generated reports are often cumbersome and difficult to understand.

At a more simplistic level, Fuller noted that the LAUSD does not have an official list of generally accepted acronyms and abbreviations for use by all LAUSD personnel.

> Conclusion #5 - The LAUSD's ability to provide timely and useful financial information to managers at all levels of the organization is seriously compromised by deficiencies in its automated systems.

Fuller concluded that the Integrated Financial System is not integrated with related applications. Although it is the main automated financial system of the LAUSD, IFS does not integrate all major financially-related systems. For example, IFS is not integrated with Maintaining, Preparing and Providing Executive Reports ("MAPPER"), the principal system used for budget development. Therefore, tapes of budget accounts are downloaded from MAPPER and uploaded into IFS to establish the general ledger accounts. Similarly, budget updates must be manually transferred back to MAPPER to adjust individual budget accounts.

IFS is lacking key capabilities that would provide managers with essential information. IFS is a large system with the capacity to generate a substantial amount of useful financial information. However, there are two capabilities it does not have that would benefit managers at all levels:

- **Position Control** - Without a functioning position control module, the difference between budgeted and unfilled positions cannot be readily determined. This information is critical to the development of an accurate budget. Without position control, the LAUSD does not know how many employees it has working in what positions at any given time, or how much they get paid.

- **Inventory Control** - According to ITD managers, IFS captures annual LAUSD-wide spending on equipment, such as computers, desks, and other equipment. However, it is not capable of reporting the warehoused or distributed inventory levels at any point in time for non-capital assets across the LAUSD. The availability of this information, online, to unit managers would be useful in developing the unit's overall budget.

IFS does not allow school-based personnel to design or print reports. End-users at school-sites are not able to manipulate baseline data within the system to create or print reports for their schools. All customized reports must be created by the Information Technology Division ("ITD") staff through a series of direct, and often very time consuming, queries to the systems main database; even standard reports are awkward to print. Most school administrators with whom Fuller spoke indicated the desire to be able to design and print reports from IFS data.

Fuller found that IFS does not permit online analysis of transactions. System users can currently identify the detail amounts and transactions underlying a summary line item. For example, a school can determine that it spent $18,500 on textbooks. However, it cannot get any further detail on the transaction (e.g., what courses the books were for, or who approved the purchase).

Apparently, IFS does not use online validation rules to control the usage of account codes. School-based and other personnel rely primarily on various manuals and other written documentation to determine the appropriate account codes to use when reporting expenditures. The input error rate, which is not insignificant, exacerbates later difficulties in data editing.

IFS was not the only automated financial system in the LAUSD about which Fuller was concerned. The MAPPER system is used to support the LAUSD's budget process. When unit budgets have been rolled-up in MAPPER, personnel in the Budget Division must export data from MAPPER to a spreadsheet program whose pages represent the resulting pages in the budget. Additionally, whenever changes occur to data in MAPPER, they are not automatically transmitted to changes in the spreadsheet program; instead, those changes must be manually incorporated into the spreadsheet program.

> Conclusion #6 - Decentralized financial management is not working effectively or efficiently in the LAUSD.

With more than 700 separate instructional locations and thousands of individual units, Fuller observed that decentralized management, to some degree, is a necessity in the LAUSD. This is particularly true with regard to financial management because an ever increasing number of schools are LEARN or special schools with limited autonomy over their finances and other management areas being part of the guiding philosophy behind their establishment. Yet, despite the need for decentralized management, financial and otherwise, which puts decision-making close to the people who are responsible for implementing them, decentralized financial management is not working effectively or efficiently in the LAUSD. Fuller found several reasons creating this situation:

- There is no clear definition of "decentralized financial management" nor are there well-defined and clearly understood policies and practices relative to that concept. Even though decentralized financial management is an articulated policy of the LAUSD, the term and the practice have not been clearly defined to allow managers in central units as well as managers "in the field" to know what is entailed and specifically what is expected of them as individuals and collectively.

- The central office does not provide adequate oversight of school administrators in their roles as financial managers. We interviewed a number of school administrators who explained that they are frustrated with the current budget and expenditure process their schools are expected to follow. Based on these interviews, it is our understanding that some administrators freely admit that they have found ways to transfer funds to circumvent existing management policies. This is often done by entering account codes which accept their transactions regardless of their appropriateness.

- Many principals see themselves as instructional leaders and not as financial managers. A majority of principals with whom Fuller spoke had no desire to be the financial managers of their institutions. Although principals clearly want to have financial freedom and as much flexibility in spending options as possible, their top priority, understandably, is directed at instructional issues.

- Most school principals and administrators are not properly trained to be financial managers. In addition to their lack of enthusiasm for the role of financial managers, most of the LAUSD's school principals and administrators lack the background and training necessary to perform adequately as financial managers. The LAUSD has sought to address this situation through various group sessions and written documents. For example, in 1996, the LAUSD produced and made available to school-based managers a document entitled, *"Budget Resources Handbook - A Guide for Local School Budgeting"*.

Fuller observed that the LAUSD's school-level budgets exacerbate the problems of school-based financial management. Schools do not work with a single budget. Often, a principal has to work with multiple budgets on both the development and execution ends.

Conclusion #7 - The LAUSD has a myriad of educational programs without a clear means for managing them for optimal effectiveness.

Fuller commented that the LAUSD carries out the vast majority of its instructional responsibilities through its myriad of "programs"; and it does an excellent job in securing grants to fund those "programs". However, to this point, it has not done an adequate job of developing and establishing policies designed to ensure that their programs are managed in an effective manner. As a result, Fuller made the following findings:

- There is no central repository of programmatic information. The LAUSD does not have a central source of information on its programs, e.g., the programs' purpose and goals, funding source(s) and evaluating criteria (if any).

- The LAUSD does not evaluate all of its programs on a regular basis. Some of the LAUSD's programs are evaluated regularly while most are not. In fact, Fuller was told that some programs have never been evaluated. The LAUSD does not have a formal plan for or schedule for evaluating any of its programs.

- There is no standard definition of "programs." Within the context of the LAUSD's nomenclature, a program could refer to activities as broad as Special Education, Integration and Title 1, it could refer to activities as narrow as a 10th grade course, State Earthquake Assistance and classroom library materials.

- The LAUSD does not have a central office of grants management. The great majority of the LAUSD's programs are funded by one or more grants. Fuller found that the LAUSD's efforts to secure grants have been very effective. This makes the proper and effective management of grants very important to the LAUSD. The LAUSD manages its grants related to activities through three separate offices. They are as follows:

- *The Office of Grants Assistance* - Under the auspices of the Deputy Superintendent for Government Relations and Public Affairs, this Office's primary functions include (1) serving as a liaison to schools and other entities within the LAUSD on the availability and nature of potential grants, and (2) the tracking of incoming grants.

- *The Program Analysis and Resource Allocation Section* - This Section reports to the Budget Director, and its primary responsibilities include the following:

  - Processing budgets for the LAUSD's grants.

  - Assisting central office personnel to prepare for and better understand the parameter of their grants (at school-sites the function is performed by Cluster Fiscal Specialists).

- *The Specially-Funded Accounting Section.* Reporting to the General Accounting Branch, this section is responsible for maintaining accounting on and producing reports relative to the LAUSD's grants.

While Fuller found no deficiencies related to the management of any of these offices, Fuller nonetheless had concerns about the following: (1) there is no central repository of pertinent programmatic or financial information on the LAUSD's grants; and (2) there is no central office or authority capable of making reasoned judgements on how the LAUSD should best manage its grants.

> Conclusion #8 - The development and implementation of the LAUSD's budget is hampered by ineffectual cooperation and coordination among the various units critical to the budget process.

Fuller found that the level of coordination and cooperation that would be expected – and is essential – among the units with major roles in the development and subsequent implementation of the LAUSD's budget does not exist. One reason for the lack of cooperation and coordination that exists among key units appears to be that some of the units lack confidence in the work of at least one of the other units. Once a unit feels it cannot depend on another--regardless of the information or services it provides – the unit tends to distance itself and to rely only upon its own capabilities and those of external units with which it has long established working relationships.

Another reason for the lack of full cooperation between and among those involved in the budget process is that inter-departmental roles and responsibilities, in some instances, are not clearly defined. Additionally, in some cases, LAUSD units have become so focused on the processes they have responsibility for that they fail to understand where their work fits into the overall context of LAUSD activities. Without such an understanding, the process becomes the unit's only point of reference. When this occurs there is little impetus for either coordination or cooperation.

Fuller noted that as a result of some of the organizational changes that the Superintendent has enacted (e.g., the consolidation of a number of budget development and implementation-involved units under the CAO), there have been some significant improvements in areas of inter-unit cooperation and confidence. Fuller observed significant inter-departmental cooperation (especially between the Budget Department and the Independent Analysis Unit) during discussions relative to options for displaying the FY 1999-00 Budget. However, additional improvement is needed.

As the result of the extensive review and analysis Fuller has made of the LAUSD's budget development and implementation processes, Fuller developed 13 recommendations designed to address the problems and issues found to be inhibiting its effectiveness and efficiency.

Recommendation #1 - Develop a formal strategic plan, covering at least five years, to provide the vision, goals and principal objectives of the LAUSD during the plan period.

The LAUSD should continue to develop and finalize the strategic plan on which it is currently working. This strategic plan need not be either overly long or complicated. However, at a minimum, it must reflect:

- A thorough analysis of the external environment in which the LAUSD will have to function during the plan period.
- An assessment of the longer-term educational needs of the LAUSD's student populations.
- An unvarnished determination of the LAUSD's strengths and weaknesses, and of the opportunities and threats it will likely encounter.
- Instructional and non-instructional general goals and specific, quantifiable and achievable objectives.
- The human, physical, financial and technical resources necessary to support the plan's implementation.
- General strategies for achieving the plan's objectives in the time available.

As an integral part of this process, the LAUSD should develop the first year of the plan in considerably more detail than subsequent years. This detailed plan will become the LAUSD's operating plan for the coming year.

Fuller observed that development of the LAUSD's strategic plan will not be an easy task. It will take time and considerable effort on the part of the Superintendent, the Deputy Superintendents and senior managers of the LAUSD, and of the various stakeholders. The principal responsibility for the development of the strategic plan is clearly that of the Superintendent. Together with his Deputies and senior managers, he must ensure that a programmatic and financially sound the plan is developed. Toward this end, Fuller recommended that a Strategic Management Committee ("SMC") be established to oversee the development of the strategic and operating plans, monitor their implementation, and make or approve modifications to the plans. The SMC should, at a minimum, consist of the Superintendent, the Deputy Superintendents, the Chief Administrative Officer, the Chief Financial Officer and the General Counsel.

Recommendation #2 - Establish a Budget Planning and Analysis Unit and charge it to provide executive managers with accurate and timely budgets and analyses.

Fuller found that the LAUSD's budget planning is not adequate for an organization of the LAUSD's size, scope of activity and complexity. Changes are critical to strengthening the overall effectiveness and efficiency of the process and require the support of a strong budget planning and analysis function to realize the desired results. For example, Fuller recommended that the Budget Planning and Analysis Unit (BPAU), which would report to the Chief Financial Officer, would serve as the principal liaison between the LAUSD's executive managers (e.g., the Superintendent, Deputy Superintendents, and the Chief Administrative Officer) and the Budget Department. Additionally, this unit would: (1) assist the, LAUSD's manager in their budget development efforts; this could be accomplished in part, by providing accurate, timely and thorough budget and expenditure analyses through regularly scheduled and *ad hoc* reports; (2) conduct regular forecasts of the LAUSD's financial position, and (3) demonstrate the manner in which budgeted resources "tieback" to the goals, objectives and priorities outlined in the Superintendent's annual operating plan.

Recommendation #3 - Extend and modify the budget development cycle to provide sufficient time for the planning and analyses essential to developing a budget consistent with established goals, objectives and priorities.

LAUSD's current budget development cycle realistically covers only a seven-month period between February and August. Fuller identified the short time-frame for this critical process as a major problem because it is not enough time to develop the type of budget Fuller recommended for the LAUSD. Specifically, Fuller recommended a budget whose funds allocations are driven by, and reflective of, the overall goals, objectives and priorities of the LAUSD. This is not the type of incremental budget that is currently produced in the LAUSD.

Fuller recommended that the LAUSD extend its budget development calendar to fourteen (14) months. This extended budget cycle should begin in July of the year prior to the operating year for which the budget is being developed. The first step in the revised cycle should be the issuance of the Superintendent's "Budget Call." The Budget Call should set forth the Superintendent's instructional and non-instructional priorities and objectives for the operating year, provide an estimate of the funding to be allocated to major programs, functions and activities, and comment on any internal or external threats or opportunities he wants considered as managers develop their action plans and budget requests.

Recommendation #4 - Conduct continual and comprehensive reviews of the effectiveness and efficiency of the LAUSD's programs.

Fuller recommended that the LAUSD expeditiously begin a comprehensive review and evaluation of the effectiveness and efficiency of its programs. Whether an instructional or non-instructional program, the LAUSD needs to know if the purposes for which individual programs were established are being met on an effective and efficient basis. Further, it needs to know if the funds being allocated to the program are being well spent. And, if the conclusion is that they are not, it needs to know why this is so:

As an initial step in its efforts to evaluate its programs, Fuller recommended that the LAUSD develop an accurate and complete database of all its programs. This information database should include, but not be limited to:

- Name of Program.
- Purpose.
- Goals.
- Measurable objectives.
- Duration.
- Funding source.
- Budget amount.

Recommendation #5 - Implement the State's new Standardized Account Code Structure (SACS), supplemented by a provision for activity-based cost accounting that is responsive to the specific needs of the LAUSD's management.

The LAUSD's current account code structure does not allow it to adequately capture, organize and report revenues and expenditures in a manner most useful for management review. With a modified and enhanced account code structure in-place, Fuller believed the LAUSD would be better able to capture and report data in a manner consistent with providing management the ability to examine how LAUSD resources are consumed by function and activity. Moreover, it would possibly enable the LAUSD to more readily capture useful data on activities that receive funding from multiple sources, and are implemented under the direction of multiple units, such as staff development and student safety. Fuller noted that the LAUSD is currently revising its account code structure in response to the State requirements. Fuller believed that the LAUSD should also have its own system of program codes to better organize its budget and expenditures. Additional analyses beyond the scope of this project will be required in order for the LAUSD to make a final judgement on this matter.

Recommendation #6 - Substantially enhance budget reporting to all levels of the organization to ensure that managers have timely and accurate information upon which to make management decisions.

Fuller found that the LAUSD currently does not produce financial reports that are easily understandable, timely, and accurate. In order to provide the LAUSD's managers with clear, timely and accurate financial reports, the LAUSD should revise the content, format, and means of distribution of its regularly produced financial reports. Additionally, the LAUSD needs to review the format and content of its published budget documents in order to provide a more comprehensible documentation of LAUSD proposed expenditures.

Accordingly, Fuller recommended that the LAUSD develop, modify and otherwise enhance the following budget-related documents:

Recommendation #7 - Put in-place a technology system that better supports the LAUSD's budget planning and implementation processes.

Fuller found that the LAUSD's existing financial information system, IFS, does not adequately support the current budget and related financial processes. Moreover, the current systems will not support the proposed budget development and implementation process recommendations. Therefore, Fuller recommended that the LAUSD take the necessary steps to ensure that it has a system in-place that will respond to its current and foreseeable budget-related needs. In this context, Fuller recommended the LAUSD redouble its current efforts and bring successful closure to the development of IFS and position control.

Recommendation #8 - Facilitate more effective decentralized financial management by clearly defining the specific roles and responsibilities of all affected managers and administrators.

Fuller found that it would be exceptionally difficult to manage and control the finances of an entity the size and scope of the LAUSD on a highly centralized basis. Therefore, Fuller recommended that the LAUSD continue its evolution to decentralized financial management and procurement – particularly in light of the LAUSD's efforts to develop goals, objectives and operating plans which should aid in allowing decisions to be made at lower levels of the organization structure. Fuller also recommended that the LAUSD move immediately to establish clearer budget and finance-related responsibilities, authorities and accountabilities for school based managers.

In addition to clearly defining and communicating the roles and responsibilities of school-based administrators (e.g., principals, vice-principals and support staff), Fuller argued that the LAUSD must also provide more direct support to those administrators with regard to both financial and procurement activities. Fuller strongly recommended that the LAUSD develop and conduct a series of brief, but relevant training courses for principals and other school-based personnel involved with decentralized financial management to help them more effectively manage the resources under their control. On a longer-term basis, Fuller recommended that the LAUSD work with representatives of the local colleges and universities concerning the possibility of enhancing the levels of general and financial management as part of the educational curriculum.

Recommendation #9 - Strengthen cooperation and coordination among all units involved in the budget development and implementation processes by more precisely defining and enforcing adherence to their individual roles and responsibilities.

Fuller recommended that the LAUSD more clearly define the roles, responsibilities, authorities and accountabilities of all units involved in the budget processes. Fuller also encouraged the LAUSD to assist its staff to better understand their individual roles in the LAUSD's overall budget process, and the paramount importance of finalizing a useful "product" as a result of engaging in an appropriate process. By taking these actions, the LAUSD is likely to increase the effectiveness of its budget process by reducing unnecessary delays, increasing the accuracy of information flows, and providing a more cooperative environment. If these outcomes come to fruition, the overall effectiveness of the LAUSD's budget process is likely to be enhanced.

Fuller also recommended that the LAUSD move to make its "line" managers more accountable for the successful completion of goal and objective-oriented tasks. To accomplish this, Fuller noted that the LAUSD probably needs to enact a system of measuring whether performance levels are realized, such as a customer survey. Such a system would result in rewards to those who substantially assist in the accomplishment of the Superintendent's goals and objectives. Conversely, the system must allow for fair, but firm rebukes for those who do not significantly assist in the accomplishment of the Superintendent's goals and objectives.

Recommendation #10 - Ensure that the Budget Department has the appropriate structure, staffing level and skill-mix to successfully implement and execute the recommended revisions to the current budget process.

Fuller recommended that a thorough assessment be conducted of the Budget Department's organizational alignment, *i.e.*, its structure, staffing, skill-mix and distribution of responsibilities. According to Fuller, the purpose of the assessment will be to:

- Determine the degree to which the current Department is prepared to meet its coming responsibilities in an effective manner.
- Recommend actions to strengthen the Department in areas of weakness to ensure that it is adequately prepared.

Given the nature of the role of the Budget Department in operating under the revised processes, Fuller argued that it was important to undertake this assessment as soon as practical. Fuller also recommended that the LAUSD consider the possibility of consolidating the Budget Planning and Analysis Unit into the Budget Department. The intent of this recommendation would be to create within the LAUSD an operating department analogous to the Federal government's Office of Management and Budget, *i.e.*, a department with the capability and credibility to not only develop the budget, but also to monitor its implementation, recommend needed adjustments and do regular forecasts of the LAUSD's financial position.

Recommendation #11 - Conduct familiarization training for all affected parties on the revised budget process and their role in it.

Due in large part to its size and complexity, Fuller found that the LAUSD's budget has traditionally been perceived to be daunting and incomprehensible. For the revised budgeting processes to function at peak efficiency, Fuller argued that it was essential that all those affected by the processes understand both the overall budget and the processes by which they are developed and implemented. Since there will be revisions to the processes in the immediate future, Fuller suggested that now is an optimal time to begin to acquaint LAUSD managers with the budget and budget processes. Accordingly, Fuller recommended the LAUSD develop and implement a program to familiarize key groups in areas such as:

- Key budget mandates and guiding principles.

- The budget calendar.
- The role of individual units in the development and implementation processes.
- Significant budget-related assumptions.
- The account code structure.
- Key terms and acronyms.
- Budget-related documents and reports (e.g., their contents and ways to use them as a basis for making management decisions).
- The need for accurate and timely reporting of accounting and budget-related information.

This budget orientation should involve groups of managers at the same or similar levels of responsibility and involvement in the budget process. We suggest the following grouping:

- Executive managers, e.g., the Board, the Superintendent, the Deputy Superintendents.
- Senior operating managers, e.g., Division Directors, Assistant Superintendents and other leaders of key operating units.
- Cluster managers, e.g., Cluster Administrators and Cluster Fiscal Specialists.
- School-based managers, e.g., Principals, Assistant Principals and Business Managers.
- Key external stakeholders, e.g., collective bargaining units, parent groups, business leaders and community groups.

Recommendation #12 - Review existing budget policies and procedures, and seek greater compliance with them by enhancing internal controls and/or frequency and magnitude of internal audits.

Fuller observed that a number of the LAUSD's employees have learned to circumvent certain established procedures by entering incorrect and inappropriate account codes. We learned further that such actions go regularly undetected - compounding the LAUSD's ability to accurately account for its costs. We noted also during the course of this project that a lack of documentation with respect to the LAUSD's budget policies and practices. Accordingly, Fuller recommended that the LAUSD review all of its written budget policies and determine the degree to which they should:

- Remain constant.
- Be modified.
- Be deleted.
- Establish new policies in areas where none currently exist.
- Enhance its levels of system-generated internal controls in an attempt to substantially reduce the occurrences of non-compliance with budget policies.
- Conduct regularly scheduled and periodic internal audits of budget policies.

Recommendation #13 - Establish a central office of grants management to oversee the development and execution of the large number of LAUSD grants.

Fuller noted that a significant portion of the monies received by the LAUSD are grant funds that have either been automatically allocated on a formula basis or that have been applied for by the LAUSD. Typically, grant funds are more complicated to manage than regular allocations because each grant has distinctive reporting and control requirements. In those cases in which grants are applied for, application requirements tend to be unique to the particular grant. Knowledge about grants management and about the art of "grantsmanship" is specialized knowledge. Fuller noted that the LAUSD currently manages its grants through three separate units: the Office of Grants Assistance, the Program Analysis and Resource Allocation Section, and the Specially Funded Accounting Sections. However, there is not an identifiable unit that brings together the needed expertise and serves as a focal point to assist the LAUSD to better manage its grants.

Fuller recommended that the LAUSD establish a central grants management office and give it responsibility for the general oversight of the grants execution process. Fuller suggested that the primary responsibilities of this unit would include, but would not necessarily be limited to serving as:

- The developer of guidelines (under the direction of the Superintendent and the Deputy Superintendent for Government Relations and Public Affairs) for seeking and accepting grants.
- A repository of key information on all grants.
- An authority on the LAUSD's "latitudes" under the terms and conditions of each grant.

The establishment of a grants management function should be accomplished as part of the overall transition to the recommended budgeting and planning processes.

V. Current Efforts By The LAUSD To Improve Its Budget Process

In reviewing the responsiveness of the LAUSD to Fuller's own review, Fuller found that since the inception of this comprehensive Budget Process Review, LAUSD took the following actions:

1. Began the process of developing a Strategic Plan (to drive budget planning process). In February 1999, the Superintendent held a planning session with his deputies to develop a set of initiatives for the 1999-2000 fiscal year. Subsequent to this planning session, this senior staff committee worked to realign the LAUSD's budget to allow for funding of the Superintendent's proposed intervention program. The Superintendent is currently working with members of his senior staff and an outside consultant for the purpose of developing a long-term strategic plan.

2. Created a Strategic Financial Planning Office ("SFPO"). On July 1, 1999, a Strategic Financial Planning Office was formed under the direction of the CAO and CFO. At that time, a Unit director was appointed and efforts to staff the office began. In the first two months of

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operations, the SFPO began to fulfill some of the budgetary analysis functions envisioned by Fuller's Recommendation #2, which called for the establishment of a Budget Planning and Analysis Unit. The SFPO has taken the lead support role in new budget planning efforts including "zero-based" budgeting, defining the set of LAUSD programs, and developing more effective budget presentations for senior staff.

3. Proposed modifications to existing budget calendar. On August 3,1999, the CFO presented to the Board a set of proposed changes to the traditional LAUSD budget development calendar. These changes closely mirror the recommendations for an enhanced budget development cycle first proposed in our June 1999 report to the (former) Business, Operations, and Personnel Committee of the Board. Major steps in the CFO's proposed new budget development calendar included tying budget development to the Superintendent's priorities and objectives, the development of a baseline budget to be used to budget planning discussions, and the conducting of stakeholder workshops to receive a variety of input during the budget development cycle. On September 23, 1999, the Budget Director, presented the proposed 2000/01 budget calendar to the Budget, Finance, Audit and Technology ("BFAT") Committee. This Committee approved this proposed budget calendar, and determined that it would recommend its approval to the full Board.

4. Begun the process of redesigning the LAUSD's budget document. In late July and early August of this year, the Budget Director made a concerted effort to collect input from various sources on ways to improve the comprehensibility and utility of the Adjusted Final Budget for fiscal year 1999-00. Primary input came from representatives of the Budget Services and Financial Planning Division, the Budget Planning and Analysis Unit, and the Board's Independent Analysis Unit. With this input, the LAUSD was able to make marked improvements to this year's Adjusted Final Budget.

5. Begun attempts to enhance IFS. Beginning in December 1998, an IFS, Strategy Committee was formed, headed by the CFO, to address both shorter and longer-term potential enhancements to the existing IFS system. The Committee is currently considering methods to simplify financial reports sent to school administrators and other LAUSD managers, provide greater system flexibility in terms of developing ad-hoc reports and printing these reports locally, and developing a more user-friendly, graphical user interface to the system's front end.

6. Begun Efforts to develop a Position Control System. Under the supervision of the Budget Director, the LAUSD's Position Control Steering Committee has been meeting since January 1999. In April 1999, a User Group Subcommittee was formed. The Position Control Implementation Analysis was implemented, in August 1999.

7. Efforts to simplify school-site fiscal management. The Budget Department has been working to provide simpler instructions to school administrators on how various budgeted funds may be expended, alleviating the extensive time spent by administrators in determining how they might be able to spend their available funds.

VI. Why Do These Conclusions Matter To Belmont?

As will be demonstrated in the following chapters, the observations of Arthur Andersen, KPMG and Fuller to the LAUSD budget, accounting and procurement systems as a whole are demonstrated in base relief in this review of how LAUSD budgeted and accounted for the funds expended at Belmont. The recent changes begun by Superintendent Zacarias and Chief Financial Officer Olonzo Woodfin are important for LAUSD. Sadly, they come too late to redeem much of the Belmont situation.

CHAPTER 5

THE BELMONT DISPOSITION AND DEVELOPMENT AGREEMENT

In order to understand the budgeting and accounting in the Belmont situation, one must first concentrate on the financial issues and arrangements embodied in the Disposition and Development Agreement with a view to explaining the terms of this agreement as between the developer, Temple Beaudry Partners and LAUSD.

A. Adoption Of The Disposition And Development Agreement

Culminating the review and selection process which identified Temple Beaudry Partners Temple Beaudry Partners ("TBP") as the preferred developer of Belmont, LAUSD and Temple Beaudry Partners entered into an Exclusive Negotiation Agreement ("ENA") on October 9, 1995, and amended the ENA on April 10, 1996. The ENA created an Exclusive Negotiation Period ("ENP"), which required the LAUSD to attempt to reach agreement with Temple Beaudry Partners regarding development of the Belmont project.[48] During the ENP, the LAUSD and Temple Beaudry Partners negotiated a Memorandum of Understanding ("MOU"), as subsequently amended twice on October 7, 1996, which MOU set forth the broad terms governing the relationship between, and responsibilities of, the LAUSD and Temple Beaudry Partners relating to Belmont.

Following an additional six months of exclusive negotiation between the parties and review by the Oversight Committee, the LAUSD and Temple Beaudry Partners entered, on April 30, 1997, into a Disposition and Development Agreement ("Disposition and Development Agreement") for construction of Belmont.[49] Continuing the exclusivity of the ENA, the Disposition and Development Agreement establishes Belmont as a "Design-Build" project, as contrasted with a "Design-Bid-Build" project. The Design-Build approach eliminates most of the competitive bidding process. Instead of seeking the lowest cost among several qualified bidders to construct a project under a Design-Bid-Build approach, the Design-Build approach has other purported advantages, including earlier project completion and a reduction in "traditional development costs."[50] Disposition and Development Agreement. The Disposition and Development Agreement couples the Design-Build approach with a "Guaranteed Maximum Price" or GMP,[51] for each of the components. This approach was intended to give certainty to the LAUSD that costs would not escalate unchecked despite the absence of a bidding process to ensure price efficiency in the construction process.[52]

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[48] This exclusivity gives the designated developer an incentive to focus significant efforts on planning for the project, but precludes the owner from seeking alternative approaches to project design or project costs.

[49] See *First Report of Findings*, pp. 81-88.

[50] See Recital C to the Disposition and Development Agreement. It is unfortunately ironic that an approach intended to reduce construction time and cost appears actually have accomplished neither goal.

[51] Section 1.5.1(a) of the Disposition and Development Agreement defines the Overall Fixed Development Price as follows: The construction costs of the Overall Fixed Development Price are separated into two (2) parts, one providing a price for the development of the School Component and the other part providing a price for the development of the Retail Component.

B. The Financial Terms Of The Disposition and Development Agreement

The crucial concepts included in the Disposition and Development Agreement, most of which arose from the Design-Build approach to Belmont, revolve around the GMPs for the various components. Taken together, these GMPs constitute the total anticipated costs for Belmont -- subject to changes in the project that would be reflected in Change Orders or other costs excluded from the GMPs that were the responsibility of LAUSD. It is vital to note, however, that the GMPs were (as the term suggests) Guaranteed Maximum Prices. Thus, in the event cost savings were realized, LAUSD stood to receive 70% to 80% of the benefit of a reduction in the total cost of the school. On the other hand, to the extent costs were shifted into the Costs of the Work that could be charged against the GMPs the amount of those savings could be reduced or eliminated by Temple Beaudry Partners to Temple Beaudry Partners's financial benefit. The likelihood of this scenario was highest in the Bid Savings/Allowances Savings context discussed below. Similarly, where costs were attributed to one GMP but re-allocated to another GMP at a later time, the true cost of a given component could be artificially reduced to avoid or minimize scrutiny by persons and entities entrusted with overseeing the propriety of the expenditures. This situation was most dramatically manifested in the allocation of the costs of the approximately $7,000,000 "Podium" for the School Component to the Retail Component at a time when the Retail Component was deemed "marginal." Thus, a re-allocation of those costs to the School Component was highly probable, yet those costs were not included at the outset for consideration in the total cost of the School Component. Again, this issue will be explored in more detail below.

1. The Budget And Fixed Price

Section 1.5 of the Disposition and Development Agreement sets forth the Budget and the Fixed Price for development of Belmont. By reference to exhibits, Subsection 1.5.1 provides the

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The School Component in turn has two elements: the basic school and the contingent elements. The maximum price to be paid for the construction cost of the basic school is the "School GMP." The maximum price to be paid for the construction cost of the contingent elements (such as additional double gym, an aquatic center, additional lighting, etc.) is the "Contingent Elements GMP." The maximum price to be paid for the development of the retail component is the "Retail GMP." The sum of the three GMPs, Temple Beaudry Partners Compensation under Article 2 and all "soft costs" (such as legal counsel payments) described in Exhibit E of the DDA shall be the "Overall Fixed Development Price."

[52] Sec. 1.5.1(a)(i) of the Disposition and Development Agreement provides: "LAUSD and Temple Beaudry Partners shall collectively engage in value engineering to control the costs of constructing the School Component; provided that, any cost savings measure must (i) comply with applicable state guidelines and LAUSD school construction policies and (ii) be a logical evolution of the Development Program and the Schematic Drawings and Design Development. Any cost savings resulting from value engineering shall be shared by LAUSD and Temple Beaudry Partners in the manner provided in Section 2.3."

Guaranteed Maximum Price for the various components.[53] The sum of these components is the "Overall Fixed Development Price" for the Belmont. The Disposition and Development Agreement shows the GMP for the School and School Parking totaling $85,875,800. See Ex. E to Disposition and Development Agreement. The GMP for the Contingent Elements was $13,503,000. Id. The GMP for the Retail Component was $6,565,700 plus $4,466,000 for Retail Parking.

Section 1.5.1(a)(i) also provides for an upward adjustment to the School Component GMP in the event the Retail Component is not built. The estimate provided for that adjustment "is in the range of $6,000,000 to $7,000,000," but no specific amount is given beyond the statement that the School GMP "shall be equitably adjusted." This lack of specificity defers the difficult issue of establishing that adjustment in advance, but almost guarantees a dispute if the issue subsequently arises. Given the Oversight Committee's view that the Retail Component was "economically marginal,"[54] deferring this issue was ill-advised.

In response to concerns expressed by the Oversight Committee that the project's costs were too high, "value engineering" was proposed to reduce those costs. Id. Value engineering has as its goal accomplishing the same construction objectives at a lower cost, without sacrificing the required level of quality. The Disposition and Development Agreement as executed instructs LAUSD and Temple Beaudry Partners to "collectively engage in value engineering to control the costs of constructing the School Component" subject to state guidelines, LAUSD policies, and consistency with the existing plans for the school. Section 1.5.1(a)(i). The majority of such cost savings, if any, were to go to the LAUSD, and Temple Beaudry Partners was to receive a substantial percentage (generally in the range of 30%) as an incentive to realize such savings. See Section 2.3. of the Disposition and Development Agreement.

2. Costs Of The Work

Section 1.5.2 of the Disposition and Development Agreement sets forth the costs were to be considered the "Cost of the Work" allocated against the GMP (and therefore establishing which costs were to be considered outside the GMP), both for pre-construction operations and as payments to the Contractor for the work constructing Belmont. See Section 1.5.2(b). "Costs of Work" specifically includes the following, with certain specified costs being excluded as insufficiently related to Belmont (such as the Contractor's capital expenses):[55]

(i) Labor Costs,
(ii) Subcontract Costs,
(iii) Costs of Materials and Equipment incorporated in the Completed Construction,
(iv) Costs of Other Materials and Equipment, Temporary Facilities and Related Items,

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[53] These components include the "School Component," composed of the "basic school" with a corresponding School GMP and the "Contingent Elements (outdoor swimming pool, additional lighting, etc.) GMP," as well as the Retail GMP.

[54] See Memorandum from Roger Rasmussen to LAUSD School Board, dated July 30, 1996, p. 2. [OMM-0007358-61] See *First Report of Findings*, Exhibit 304.

[55] See Section 1.5.2(c) of the Disposition and Development Agreement.

(v) Miscellaneous Costs,
(vi) Emergencies,
(vii) Other Costs,
(viii) Contractor's Fee, and
(ix) General Conditions Supervision.

Permitted increases to the GMP, which could result in a higher ultimate cost to the LAUSD under section 1.5.3 included costs for: (a) costs for Hazardous Material remediation in excess of allowances, (b) certain changes in School Component requirements, (c) additional costs associated with CEQA (California Environmental Quality Act) requirements and/or related mitigation measures, (d) certain costs associated with conditions imposed to obtain governmental approvals, (e) certain new regulations or mandates for schools, (f) site conditions, including the "oil field conditions" and "the discovery of Hazardous Materials, (g) delays in construction resulting in actual cost increases caused by the site conditions in clause (f) "and any other matters described in clauses (a) through (e)," and (h) Temple Beaudry Partners costs, if any, to acquire certain additional real property. Given the status of a number of the matters set forth in (a) through (h), there was a high likelihood that additional costs would be incurred.

It was the view of the LAUSD personnel that, rather than incorporate these costs into the GMP for a "sum certain," it would be better for the LAUSD to pay for them as such costs arose.[56] This approach was shaped by the following purported benefits: (1) that LAUSD, as owner of the Belmont property, would be liable for these costs in any event, (2) that LAUSD should retain the responsibility and authority over issues related to health and safety, and (3) that Temple Beaudry Partners (or any other developer) would have necessarily inflated such costs due to uncertainty.[57] The result of including these costs in the GMP would, in addition, have increased the stated maximum costs of Belmont substantially from a base that already exceeded the corresponding state standards.[58]

As was stated in the first *Report of Findings*, while such an approach might have elicited even more advance scrutiny, it might also have been a more accurate representation of the true costs of building on this site. Further, the Disposition and Development Agreement could have provided a cap for these costs and shifted responsibility to the developer. LAUSD rejected this approach, however, preferring to retain control of setting acceptable standards.

3. Bid Buyout And GMP Reductions

The Disposition and Development Agreement anticipates that certain categories of costs will not initially be "firm," but will instead be more in the nature of estimates. The same concerns raised about the wisdom of deferring the allocation of shared construction elements between the School and Retail components could be raised regarding the use of estimates in the elements of the GMP. However, the Disposition and Development Agreement did attempt to place "caps" on these costs and to provide incentives for Temple Beaudry Partners to realize cost savings by reducing the amounts paid to subcontractors. In such a case, those estimates were to be finalized when the working drawings for construction were completed as construction progressed. When 70% finalization had occurred, the "Bid Buyout Date" would be established. On that date, any net savings (after subtracting any net overages in the non-estimated categories) would be considered the "Bid Savings." Seventy percent (70%) of the Bid Savings would be applied to reduce the corresponding GMP, and thirty percent (30%) would be transferred to a Reserve Account. See Section1.5.4.

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[56] Interview with David Cartwright, dated July 29, 1999.

[57] Id.

[58] See Memorandum from Roger Rasmussen to LAUSD School Board, dated July 30, 1996, p. 2. [OMM-0007358-61] First *Report of Findings*, Exhibit 304.

It is not apparent to the Internal Auditor why the Bid Savings should be calculated by subtracting overages on "firm" bids. Additionally, it is apparent from this arrangement that Temple Beaudry Partners and Turner/Kajima would have an incentive to minimize the Bid Savings to avoid the loss of the percentage payment that Turner/Kajima received on subcontractors' payments as well as to avoid having these costs deducted from the GMP money available to pay costs that arguably should have been borne by Temple Beaudry Partners as the Developer rather than included in allowances in subcontractors' costs. For these reasons, advice given by David Cartwright of O'Melveny & Myers to LAUSD was potentially misleading, because it seemed to suggest that LAUSD could relax its standard invoice oversight function.[59]

4. Other Allowances

The School and Contingent Element GMP included another category of "allowances" (such as utility connection costs and pre-apprenticeship programs). At approximately the same time as the Bid Buyout Date, these allowances were to be fixed to the extent feasible. If this process yielded "Allowance Savings," the corresponding GMP would be decreased dollar for dollar. If instead there were an overage, LAUSD would be given an opportunity to modify the Development Program to eliminate the overage. If LAUSD did not do so, LAUSD was required to execute a change order to the corresponding GMP.

5. Contingencies

Reserves for Developer contingencies were also included in the GMP. Within 30 days after the Bid Buyout Date, the parties were to agree to a reduction in Developer's Contingency Reserves to reflect the then-current situation. Any reductions were to reduce the corresponding GMP by 70%, with 30% going into the Reserve Account. Absent agreement, the entire contingency reserve would be transferred to the Reserve Account.[60]

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[59] December 9, 1998 memorandum BL-05804. See Exhibit 72.

[60] This gave Temple Beaudry Partners a strong incentive not to agree to reduce the Contingency Reserves, because under the Disposition and Development Agreement Temple Beaudry Partners stood to receive 50% of the Reserve Account and therefore would benefit from maximizing the Reserve Account by minimizing the amount applied to reduce the GMP. Again, the advice by Mr. Cartwright of O'Melveny & Myers was misleading given these issues. See December 9, 1998 memorandum BL-05804.

6. The Reserve Account

The Reserve Account was to be established on the Bid Buyout Date from any Bid Savings and contingencies transferred to the Reserve Account. The Reserve Account was to be used for contingencies, unexpected costs or cost overruns,[61] unless expressly prohibited by the Disposition and Development Agreement. Unused amounts in the Reserve Account would be shared equally by LAUSD and Temple Beaudry Partners. Thus, LAUSD would ultimately receive 85% of unspent Bid Savings, by having the first 70% of such savings applied to reduction of GMP and by receiving half of the 30% transferred to the Reserve Account if that amount was not spent.

7. Article 2 – Temple Beaudry Partners Compensation

Article 2 of the Disposition and Development Agreement provides for Temple Beaudry Partners's compensation, which is set by section 2.1 at $3,262,500 for the School Component. A "Completion Guarantee" in the amount of an additional $1,600,000, to be paid by the District in two installments, is provided for in Section 2.2. Incentives for Temple Beaudry Partners to complete Belmont "under budget" are provided by Section 2.3, which gives Temple Beaudry Partners a share of certain cost savings and an early completion bonus.

8. Article 3 – Environmental And Site Conditions

Article 3, entitled "Environmental and Site Conditions," discusses the known site conditions with emphasis on the Oil Field Conditions. See sections 3.1 and 3.2(c). Section 3.2 also discusses the CEQA status of Belmont and refers to the required CEQA mitigation and implementation of that mitigation. See Sections 3.2(a) and (d). The Disposition and Development Agreement then contains two separate sections allocating responsibility for environmental conditions. The first, Section 3.3, addresses pre-existing, known contamination and the second, section 3.4, generally addresses claims arising from contamination. With respect to pre-existing contamination, Temple Beaudry Partners is "exculpated" from costs or delay. That section allows Temple Beaudry Partners to increase the Overall Fixed Development Price to recoup costs incurred by Temple Beaudry Partners to perform remediation. See Section 3.3. LAUSD also indemnifies Temple Beaudry Partners for any Claims caused by or arising from Hazardous Materials, except to the extent such Claims are caused by negligence or willful misconduct of Temple Beaudry Partners or entities related to Temple Beaudry Partners.

Despite these risk allocations to the LAUSD, Temple Beaudry Partners remained responsible for constructing Belmont "in a workmanlike and non-negligent manner." Section 3.4(c). Temple Beaudry Partners also covenanted and agreed "that all construction shall be performed in accordance with all applicable laws, ordinances, rules and regulations." See Section 4.8. Temple Beaudry Partners further warranted that it would "be responsible for both the design and construction of the Project . . . and that the Project . . . shall comply with the Disposition and Development Agreement. All available Uniform Commercial Code warranties shall also apply

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[61] No explanation is given as to why these monies would be applied to cost overruns to the extent such overruns were on "firm" bid items, or even if doing so was permissible.

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to Temple Beaudry Partners performance . . . ." See Section 4.10(a). Temple Beaudry Partners also warranted and guaranteed that the School Component would satisfy the State's standards for school construction. See Section 4.10(b). Temple Beaudry Partners had broad design and construction responsibility and authority.

9. Article 4 – Construction Of School Component

Section 4.2 of the Disposition and Development Agreement gave the Owner's Representative (this entity represented LAUSD) responsibility for coordinating with Temple Beaudry Partners, reviewing and approving Temple Beaudry Partners's requests to be paid. The Owner's Representative was to act in an advisory capacity and was without authority to direct activities at the job site or overrule construction management decisions of Temple Beaudry Partners's contractor.[62]

10. Section 4.3 Payment Schedule

Temple Beaudry Partners is to submit monthly Developer Payment Requests based on the proportion of work completed. See section 4.3 (a). The percentage of completion is to be based on the "most updated schedule of values" which is to be made available to the Owner's Representative. A pro rata share of the general conditions is to be included in the payment request. The requests are subject to the reasonable approval of the Owner's Representative and the Architect. Id. Additional information regarding payments of subcontractors, changes in schedule, and other relevant information are also to be certified by Temple Beaudry Partners. See Id., and Disposition and Development Agreement Exhibit Y.

Certain additional payments such as Temple Beaudry Partners Compensation as developer and items in the Overall Fixed Development Price that are in addition to the School GMP are also to be paid by LAUSD. See section 4.3 (c); BL-00763.

LAUSD is authorized to retain 10% of each payment due to Temple Beaudry Partners until 35 days after a notice of completion is recorded; the retainage percentage falls to 5% after 50% completion of the School Component. See Id. at (d). Material inaccuracies by Temple Beaudry Partners would entitle LAUSD to return an additional percentage of the Cost of Work equal to 150% of the inaccuracy. Section4.3 (e). The final payment is to be made within 45 days after substantial completion is attained. Section 4.3 (f).

11. Section 4.3.1 Inspection, Reports And Audit Rights

Temple Beaudry Partners was responsible for hiring inspectors and providing reports on the construction. Section 4.3.1(a). LAUSD had the right to review and audit all records pertaining to the construction. Section 4.3.1 (b). LAUSD also had the right to withhold or reduce payments if any one or more specified situations (defective construction, failure to pay subcontractors, etc.) occurred. Section 4.3.2.

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[62] See BL-00761, Exhibit 70.

12. Section 4.4 Change Orders

The Disposition and Development Agreement gives LAUSD the right to modify the Project by written change orders, with corresponding modification in the corresponding GMP if appropriate.

13. Section 4.6 Good Faith And Fair Dealing

Under these provisions of the Disposition and Development Agreement, Temple Beaudry Partners agreed to the following:

> "Temple Beaudry Partners shall fully and faithfully administer and enforce the Construction Contract against the Contractor in accordance with the terms and provisions thereof and in the manner necessary to ensure completion of the School Component in accordance with the terms and provisions of this Disposition and Development Agreement and to protect all of LAUSD's rights under this Disposition and Development Agreement."

C. The Structure Of The Disposition And Development Agreement Creates An Inherent Conflict Of Interest Between LAUSD And Temple Beaudry Partners Regarding Cost Savings

The Internal Auditor has reasonable cause to believe that the risk of inappropriate allocation of costs by Temple Beaudry Partners and disincentives for Temple Beaudry Partners to allocate costs to LAUSD's benefit were inherent in the structure created by the Disposition and Development Agreement. The contract "buy-out" opportunity which would benefit the LAUSD may never be realized. Only the integrity of Temple Beaudry Partners and the talents of LAUSD's representatives could prevent large-scale cost shifting that would imperil LAUSD's "buy-out" right under the Disposition and Development Agreement to receive millions of dollars in cost savings. Further, the decision to allocate costs to the "marginal" Retail Component with the knowledge that those costs were highly likely to ultimately be shifted to the costs of the School Component masked from timely scrutiny additional millions of dollars of costs from the outset of Belmont.

CHAPTER 6

BUDGETING AND FINANCING BELMONT

I. The Disposition And Development Agreement's Guaranteed Maximum Price(s)

The Disposition and Development Agreement, executed on April 30, 1997, was the legal and contractual basis for the LAUSD's budgeting for Belmont's construction. As discussed in Chapter 5, the Disposition and Development Agreement established the "Overall Fixed Development Price," which represented the sum of the major components at "Guaranteed Maximum Prices," including the "School Component," composed of the "basic school" with a corresponding School GMP, the "Contingent Elements" (outdoor swimming pool, additional lighting, elements for a joint powers agreement with the City of Los Angeles, etc.) GMP, and the Retail GMP. The Disposition and Development Agreement reflected, then, an Overall Fixed Development Price of $110,410,500, composed of the following components:

• GMP for the School and School Parking:	$85,875,800[63]
• GMP for the Contingent Elements:	$13,503,000[64]
• GMP for the Retail Component:	$11,031,700 (includes Retail Parking).[65]

LAUSD ostensibly contracted for a high school[66] at Belmont for the "guaranteed maximum price" of $85,875,800, subject to an extensive array of possible increases or decreases as set forth in the Disposition and Development Agreement.

However, the LAUSD was consciously at risk that costs associated with the other elements, including the retail and contingent elements (including proposals for joint use of the proposed recreational facilities at Belmont by LAUSD and the City of Los Angeles), might bleed back onto LAUSD's side of any final payment responsibility ledger.

To translate these costs from the context of the Disposition and Development Agreement to a concrete financing work plan required that a budget be established and integrated into the LAUSD accounting system, both to drive the funding requirements for the project and then track the actual expenditures as compared to approved and budgeted amounts. The LAUSD's policy goal from the execution of the Disposition and Development Agreement in April of 1997 forward was to finance the project initially via some form of borrowed funds necessary to complete the project, seeking either concurrent or subsequent reimbursement of some or all of these borrowed funds from state and/or local bond moneys.

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[63] See Ex. E to Disposition and Development Agreement

[64] Id.

[65] Id.

[66] The Internal Auditor was informed by Dr. Betty Hanson that during the design of the Belmont project the LAUSD addressed the *Rodriguez* consent decree's cap on the number of students in a school by designing five separate "academies" within one complex. LAUSD compliance with the *Rodriguez* consent decree is subject to the supervision of the General Counsel's office. Interview of Dr. Betty Hanson, dated December 3, 1999.

In the late spring of 1997, the LAUSD had three realistic options by which to achieve permanent financing of Belmont: (1) local Proposition BB bond moneys authorized by the voters for use by the LAUSD in construction of local schools, (2) reimbursement of allowable construction costs from the State Department of Education via the State Allocation Board, or (3) LAUSD general fund moneys, either through direct expenditure or by tax-exempt borrowing via Certificates of Participation.

II. Proposition BB Bonds

LAUSD received authorization via voter adoption of Proposition BB on April 8, 1997, to issue up to $2.4 billion in general obligation bonds to provide needed health and safety improvements to more than 800 deteriorating school buildings and 15,000 classrooms. While the use of Proposition BB bonds for new school construction (particularly for Belmont) was a controversial element of the election campaign debate leading up to the adoption of the proposition, the Proposition BB Oversight Committee in June of 1997 indicated that it would consider reimbursing LAUSD for up to 50% of Belmont's construction costs, provided that LAUSD first secured the initial 50% from the State Allocation Board.[67]

III. California State Department Of Education's State Allocation Board

A. The Role Of Mr. Dominic Shambra And The LAUSD Office Of Planning And Development

The first working Belmont budget was created for purposes of submitting an application to the California State Department of Education's State Allocation Board for at least a 50% reimbursement of the school-related costs at Belmont. This application was prepared and submitted to the State Allocation Board on February 26, 1997 (prior to the final execution of the Disposition and Development Agreement in April of 1997) by the Office of Planning and Development, under the leadership of Mr. Dominic Shambra as that Office's Director and with the primary assistance of Dr. Betty Hanson, an outside consultant who previously worked with the State Department of Education.

While the Disposition and Development Agreement was always characterized as a "design/build" agreement by both sides, the use of "design/build" methods for California public schools was not used by the State Department of Education. Though the California State Legislature expressly provided in AB 481[68] for reimbursement by the state of "design/build" projects for public schools, the State Department of Education had not, by the summer of 1997, implemented AB 481 or approved any "design/build" reimbursement applications. LAUSD's Belmont application, then, was submitted as a "standard application in the Lease/Purchase Program rather than as a joint-venture project pursuant to AB 481."[69]

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[67] Memorandum from Olonzo Woodfin, Chief Financial Officer, to members of the Board of Education, Superintendent Dr. Ruben Zacarias and Howard Miller, Chief Operating Officer, dated December 10, 1999, entitled "Los Angeles Times Article Regarding Belmont Learning Complex Certificates of Participation (COPs)." See Exhibit 64.

[68] California Education Code § 17060(c)(3).

Table 6-1 sets forth a summary of the budget submitted by LAUSD to the State Allocation Board as summarized by the State Allocation Board staff on June 25, 1997.[70]

TABLE 6-1

Budget Categories	Budget Submitted to SAB for Reimbursement **June 25, 1997**
Land Acquisition	$64,160,692
Appraisal Fees	
Escrow Costs	
Surveys	
Site Support Costs	
Relocation Assistance	
Attorney Fees	
Demolition	
Architect Fees	
Other Planning Costs	$5,507,590
New Construction	$79,598,600
Tests/Inspection	$765,000
Furniture & Equipment	$3,013,500
Rental Property Maintenance	
Contingencies	$2,297,681
[redacted]	
Totals:	**$155,343,063**

The land acquisition costs had already been approved and paid by the State Allocation Board, including $31.9 million for the 11 acre parcel, approved on August 26, 1992, and $30.1 million for the 24 acre parcel, approved on February 23, 1994. As a result, the application sought 50% reimbursement of the remaining $93,343,063. In short, on behalf of the LAUSD, Mr. Shambra's position anticipated in the summer of 1997 that a total of $93,343,063 would be needed to complete Belmont. This number is significantly above the "basic school" Guaranteed Maximum Price contemplated in the Disposition and Development Agreement, suggesting that

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[69] Page Two of the Report of the Executive Officer, State Allocation Board Meeting, June 25, 1997. See Exhibit 63.

[70] LAUSD sold as "Series A" bonds in July, 1997, for $356 million.

Mr. Shambra always contemplated seeking reimbursement for costs above and beyond the basic school portion of Belmont.

Conspicuously absent from the budget set forth in Table 6-1 above, however, is any request for reimbursement of environmental costs associated with Belmont. While Mr. Shambra was aware that future environmental costs would be encountered, and that such environmental costs would be incurred largely by the LAUSD alone, he and Dr. Hanson consciously made a "judgment call" not to include a request for reimbursement of these environmental costs.[71] Indeed, the Internal Auditor has been unable to find any estimate (whether in the documentary record or by interview) of likely environmental costs to be encountered at Belmont beyond the $2 million figure discussed and occasionally set forth in the various documents prepared during the negotiation of the Disposition and Development Agreement as to the likely overall costs at Belmont.[72] Mr. Shambra and Dr. Hanson did not even attempt to recoup this $2 million figure, or provide for any potential "contingent" state reimbursement for such costs. They argued, apparently at the time, and later individually in their interviews with the Internal Auditor, that since the environmental remediation costs were uncertain, and since the State Allocation Board did not typically reimburse "contingent" costs, including a request for reimbursement of likely environmental costs was "not a smart political move to make" and might well have jeopardized the overall application.[73] Yet Dr. Hanson admitted in her interview with Internal Auditor that the State Allocation Board had in fact reimbursed environmental costs incurred by several school districts on capital/construction projects prior to LAUSD submitting its Belmont reimbursement application.[74]

In any event, the State Allocation Board denied this application for reimbursement of Belmont-related construction costs later in 1997.

B. The Role Of Ernst & Young As Outside Real Estate Finance Consultant To LAUSD

Mr. Shambra originally retained the E&Y Kenneth Levanthal Real Estate Group ("Ernst & Young") as a real estate finance expert to assist his Office in evaluating the various proposals from the prospective developers vying for the right to enter into exclusive negotiations with LAUSD on Belmont. Ernst & Young was doing work at the time for Kajima in its Dallas and Washington, D.C. offices, and disclosed this fact of potential or real conflict of interest in a letter to Mr. Shambra dated April 4, 1995.[75] On May 23, 1995, Ernst & Young participated in the final evaluation of the developer candidates, and concurred in the selection of Temple Beaudry Partners that was passed on to Mr. Shambra on June 9, 1995. Previously, on June 7, 1995, Ernst

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[71] Interviews of Mr. Dominic Shambra and Dr. Betty Hanson with the Internal Auditor.

[72] This $2,000,000 is incorporated into numerous versions of the proposed Belmont GMP budget as prepared by Ernst & Young, LAUSD's outside real estate finance consultant.

[73] Id.

[74] Id.

[75] See Exhibit 298, from the first *Report of Findings*. A unit of Kajima International is a partner in the Temple Beaudry Partners. There is no evidence in the record that this conflict was waived by the LAUSD Board of Education, though this written disclosure was made a second time to the LAUSD General Counsel on September 12, 1995. Id.

& Young prepared for Mr. Shambra an evaluation letter that assessed the identified guaranteed and contingent revenues proposed to the LAUSD from each development team.[76] This analysis contained a $20 million overstatement of the Temple Beaudry Partners' contingent revenue, an error that subsequently received significant media attention and criticism as a purported unfair advantage being given to Temple Beaudry Partners. However, Mr. Shambra has stated that the contingent revenues were not given any weight in the evaluation processes.

Notwithstanding these earlier problematic interactions between Ernst & Young and his office, Mr. Shambra's failure to contemplate or prepare an owner's contingencies line item for environmental costs at Belmont flew directly in the face of express advice provided to Mr. Shambra on December 11, 1996, by Ernst & Young, still acting as his outside real estate financial consultant.[77] Apparently Mr. Shambra and Dr. Hanson's failure to contemplate or prepare an accurate contingent environmental budget at Belmont, and then include that budget estimate in their State Allocation Board application, effectively blinded the LAUSD from making a thoughtful, realistic appraisal of the likely environmental costs that would necessarily have to be incorporated somewhere into the real, ultimate costs of Belmont.[78] Apparently, LAUSD contingency reserve or budget line item was ever developed by LAUSD internally or as part of any attempt to obtain reimbursement from state or local sources.

While it is unclear whether Ernst & Young was provided with, or asked to address prior environmental cost estimates (*i.e.*, ABB's estimates for mitigation of methane exposures on the 11 acre parcel submitted on May 22, 1990), the Internal Auditor is troubled that Ernst & Young did not affirmatively address the issue of environmental contingencies in a more aggressive, professional manner. On December 2, 1996, in internal correspondence from Ernst & Young's David Bentley to his supervisor, Steve Valenzuela, both Mr. Bentley and Mr. Valenzuela (via handwritten comments) acknowledged that Temple Beaudry Partners, as the Belmont developer, was pushing to remove from the proposed agreement the $2,000,000 "Other, Unforeseen Subsurface Conditions line item," the item expressly designed to address environmental contingencies.[79] This issue was revisited in a second internal Ernst & Young memorandum from Mr. Bentley to Mr. Valenzuela dated December 10, 1996.[80] However, in their final letter to Mr. Shambra, this entire question of the shifting $2,000,000 environmental contingency is omitted from the advice given to Mr. Shambra.

Similarly, Ernst & Young apparently failed to convey to Mr. Shambra their exploration of possible insurance options to address these environmental issues. Again, in internal correspondence from Mr. Bentley to Mr. Valenzuela dated March 5, 1997, an express reference is made to the potential use of environmental insurance in a draft recommendation to Mr. Shambra as to the potential overall use of insurance on the project:

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[76] Letter from Steve Valenzuela to Wayne Wedin, dated June 7, 1995. [OMMBEL009513-517] See Exhibit 263, first *Report of Findings*.

[77] See the letter dated December 11, 1996, from Steve Valenzuela, Senior Manager the E&Y Kenneth Levanthal Real Estate Group (Ernst & Young LLP), p.1. See Exhibit 56.

[78] Virtually every LAUSD official, junior or senior, points to Mr. Shambra and his legal, financial and government affairs team as the key source of information and the decisive staff decision-maker on policy regarding the development and initial construction phase at Belmont.

[79] See Exhibit 57.

[80] See Exhibit 62.

> Further, we believe a project wrap-up insurance policy should be investigated as a cost saving alternative. There has been a dramatic increase in the number of wrap-up insurance programs nationwide resulting in pricing that is so low that most wrap-ups written today present little or no downside financial risk to the sponsor, especially when compared with the cost of each contractor obtaining coverage on its own. **Additionally, policy terms are also broader than ever as insurers address some of the unique risks associated with design-build construction, environmental remediation, and brownfield construction**[81]

Yet in his March 10, 1997 letter to Mr. Ken Reizes of Temple Beaudry Partners, Ernst & Young's Bentley omitted any reference to environmental insurance options from his discussion of wrap-up insurance. Mr. Bentley copied Mr. Shambra on this letter by way of a "cc," but failed to provide Mr. Shambra the information about environmental insurance.[82]

The use of wrap-up insurance was not negotiated into the final version of the Disposition and Development Agreement. Indeed, Builders' Risk Insurance was expressly omitted from the final Disposition and Development Agreement budget, as was any reference to an LAUSD contingency line item generally or a contingency line item for environmental remediation specifically.[83]

IV. The 1997 Certificates Of Participation

In light of the temporary denial of reimbursement by the State Allocation Board,[84] which therefore precluded use of Proposition BB funds, the need to resort to LAUSD general fund money to begin construction of Belmont became an imperative.

A. The Variable Rate Note Structure For The 1997 Certificates Of Participation

On December 9, 1997, LAUSD closed the sale of $91.4 million in Certificates of Participation for use in building Belmont.[85] This debt was secured by a number of LAUSD properties, but did not include Belmont itself as one of those properties. Belmont was omitted as collateral on this borrowing principally to avoid having to capitalize the interest payments necessary to retire the debt.[86] As a result, this financing did not have to contend with the typical disclosures as to the environmental conditions at Belmont.

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[81] See Exhibit 58. Ernst & Young apparently were aware of these insurance market options based upon information provided to them by Johnson & Higgins Construction Group, a unit of Johnson & Higgins, one of the largest privately held insurance brokerage and benefit consulting firm in the world.

[82] See Exhibit 59.

[83] See Exhibit 70.

[84] The denial of this specific LAUSD application did not, however, preclude the LAUSD from submitting a new application at a future point in time.

[85] O'Melveny & Myers acted as legal counsel in this financing, and Ernst & Young provided the necessary audited financials.

But the most unusual aspect of this debt financing was the use of a variable interest rate for the notes. While LAUSD had previously financed a design/build project at the Francisco Bravo Medical Magnet using Certificates of Participation, LAUSD had never before issued a variable interest rate note on a capital project.

While the negotiations of the Disposition and Development Agreement had contemplated a number of financing techniques (including consideration of developer financing) to effectuate this likely need to secure funds until permanent financing could be arranged, at the strong insistence of then-LAUSD Chief Financial Officer Henry Jones, the use of Certificates of Participation were determined by the LAUSD to be the most cost-effective means of short-term debt financing at Belmont. Mr. Jones' primary criticism of the developer-financed proposals put forward by Temple Beaudry Partners was their overall cost. Because Temple Beaudry Partners could not obtain access to fully tax-exempt financing, the LAUSD (which could utilize complete tax-exempt financing options as public entity) could finance the construction at a lower cost of funds (including interest and fees). Mr. Jones did, however, find one element of the Temple Beaudry Partners' proposals intriguing -- the use of so-called "floaters," a form of variable rate debt obligations that take advantage of variable interest rates, to be achieved in this case by continually selling and reselling the tax-exempt instruments on a weekly basis, rather than selling them once on a fixed-rate basis over the life of the issue (usually 20 or 30 years).[87]

Building upon an idea originally advanced by Temple Beaudry Partners, LAUSD's then-Chief Financial Officer Henry Jones discovered that by taking advantage of the actual interest rate markets on a weekly basis, he could borrow at rates substantially below prevailing fixed rate interest levels.[88] While obtaining among the lowest tax-exempt interest rates available,

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[86] The value of the Belmont property would have to be based on its value as completed, requiring the financing to borrow both the principal and interest to pay the note, which would have increased the cost of the financing (according to Mr. Woodfin and his financial advisors at C.M. deCrinis & Co., Inc.) by 10%. Memorandum from Olonzo Woodfin, Chief Financial Officer, to members of the Board of Education, Superintendent Dr. Ruben Zacarias and Howard Miller, Chief Operating Officer, dated December 10, 1999, entitled "Los Angeles Times Article Regarding Belmont Learning Complex Certificates of Participation (COPs)." See Exhibit 64.

[87] LAUSD Memorandum dated August 28, 1996, from Henry Jones, Chief Financial Officer, to LAUSD Board Members and Superintendent Sidney A. Thompson, entitled "Belmont Learning Complex - School Financing Analysis." See Exhibit 65.

[88] The last issuance of Certificates of Participation prior to Belmont occurred in 1996 to finance 250 portable classrooms, and featured an annual interest rate call feature, which was denominated as a one year interest rate of 3.8%, running up to a 5.5% rate at the maximum end of the twenty year note period. A subsequent issuance in June of 1998 to refinance a number of other projects, again featured an annual interest rate call feature, which was denominated as a one year interest rate of 4.00%, running up to a 5.25% rate in the tenth year.

Mr. Jones backstopped the risk by taking out an interest rate cap insurance agreement to limit the upward interest rate exposure to 6%.[89]

When this financing method came under criticism in the *Los Angeles Times* in December of 1999, LAUSD Chief Financial Officer Olonzo Woodfin responded by noting that "If we had issued fixed interest rate COPs with an 'Any-time Call' provision, which allows all or a portion of the COPs to be called, it would have cost from 10 to 20 basis points or from $180,000 to $360,000 over the same two period that the "Interest Rate Cap" agreement was purchased for $36,170 covered. In addition, the lower variable interest rate has saved the District $2.8 million in interest payments so far. The latest interest rate on the Belmont COPs is 3.05% for the week of December 8 through 14 [1999]."[90]

B. The Budget Behind The 1997 Certificates Of Participation

In order to structure the 1997 Certificates of Participation to meet Belmont's construction needs, the Chief Financial Officer apparently utilized a simplified budget to reach the $91.4 million financing number. As Table 6-2 sets forth below, the budget categories corresponded to the most basic budget categories required for State Allocation Board reimbursement.

TABLE 6-2

Program Code	Description	Budget Amount
1025	Sites	$ 2,000,000
1026	Construction	$ 86,310,434
1029	Plans	$ 1,500,000
3484	Cost of Issuance	$ 1,297,385
29.61	BLC Fee Payment	$ 292,181
	TOTALS	$ 91,400,000

This information,[91] supplied to the Internal Auditor by the Acting LAUSD Controller, Ms. Yoshi Fong, at the close of business on Friday, December 10, 1999, was characterized by Ms. Fong's cover memorandum as the "budget that was established for the 1997 Belmont

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[89] Memorandum dated December 9, 1997, from Henry Jones, Chief Financial Officer, to LAUSD Board Members and Superintendent Dr. Ruben Zacarias, entitled "$91,400,000 LOS ANGELES UNIFIED SCHOOL DISTRICT VARIABLE RATE CERTIFICATES OF PARTICIPATION (COPs) (Belmont Learning Complex) 1997 Series A" See Exhibit 66.

[90] Memorandum from Olonzo Woodfin, Chief Financial Officer, to members of the Board of Education, Superintendent Dr. Ruben Zacarias and Howard Miller, Chief Operating Officer, dated December 10, 1999, entitled "Los Angeles Times Article Regarding Belmont Learning Complex Certificates of Participation (COPs)." See Exhibit 64.

[91] Memorandum from Yoshi Fong to Maruch Atienza dated April 21, 1998, entitled "Belmont Learning Complex Budget Adjustment." See Exhibit 67.

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Learning Center COPs." However, neither Ms. Fong's cover memorandum nor the memorandum setting forth this budget has a narrative explanation – indeed, this latter memorandum on its face characterizes the then-existing 1997 Certificate of Participation budget as having only two categories: #1029, for "Plans," set at $81,283,918, and #3483, for "Cost of Issuance," for $1,447,350. These two items together total only $82,731,368, leaving $8,668,732 unaccounted for in the then-"Current" budget for the 1997 Certificate of Participation.

Mr Olonzo Woodfin recalls and informed the Internal Auditor that the $2,000,000 figure listed for "Sites" in Table 6.2 above reflected the consensus view as to the possible environmental costs, and thus constituted the LAUSD's environmental contingency reserve.[92] No underlying documentation for this budget was provided to the Internal Auditor, and Mr. Woodfin did not provide any documentation to confirm his recollection that the Certificates of Participation sale contemplated in fact a $2 million environmental reserve.

While the categories in this budget for the 1997 Certificates of Participation were nominally designed to permit application for repayment, this budget bears no clear resemblance to the budget prepared by Mr. Shambra's Office of Planning and Development as summarized by the staff of the State Allocation Board in June, 1997 (see Table 6-1 above), nor to the basic school portion of the Disposition and Development Agreement.

Based upon the documents and testimony provided the Internal Auditor, the budget estimate for the construction of Belmont at the time construction actually began in the fall of 1997 appears to have been approximately $89,810,434, all of which was to be financed by the proceeds of the 1997 Certificates of Participation.

V. The Debate Over What Was Actually "Permitted" In The Expenditures For Belmont

In May of 1998, then-Chief Financial Officer Henry Jones wrote a memorandum to Raymond Rodriguez, who at that time was functioning *de facto* as the project officer for Belmont (according to Mr. Rodriguez, he was only "coordinating" matters for Belmont).[93] Mr. Jones was concerned about newspaper articles in the *Daily News* indicating that the "retail" portion of Belmont was still being built, notwithstanding the apparent decision in 1997 to proceed with construction on the assumption that no retail would be included in the project. Mr. Jones wrote to remind Mr. Rodriquez that no moneys raised through the 1997 Certificates of Participation could be used to finance anything but the school portion of Belmont. The approximately $7 million in purported retail costs, Mr. Jones noted, had to be paid at the end of the project by someone other than LAUSD, or the 1997 Certificates of Participation's tax-exempt status would be jeopardized. Mr. Jones pointedly noted that this state of affairs had been explained by Mr.

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[92] Mr. Woodfin also took this position in a recent memorandum to the LAUSD Board of Education on the subject. Memorandum from Olonzo Woodfin, Chief Financial Officer, to members of the Board of Education, Superintendent Dr. Ruben Zacarias and Howard Miller, Chief Operating Officer, dated December 10, 1999, entitled "Los Angeles Times Article Regarding Belmont Learning Complex Certificates of Participation (COPs)." See Exhibit 64.

[93] Memorandum from Henry Jones to Ray Rodriguez, dated May 29, 1998, entitled "Retail for Belmont Learning Complex." See Exhibit 68.

Woodfin to Dominic Shambra, Elizabeth Louargand, Rodger Friermuth and Lisa Gooden in a meeting held on October 17, 1997.

Following a non-specific response memorandum from Mr. Rodriguez, Mr. Jones wrote again to Mr. Rodriguez on June 16, 1998,[94] stating that:

> Since the retail component and the corresponding financing for that component were not finalized at the time we issued the Certificates of Participation (COPs) in late November, 1997, the COPs proceeds are funding the entire Belmont project construction including the $7 million in infrastructure and parking costs that would have been paid for by the retail component. According to the February 10, 1997 report presented by Dominic Shambra and approved by the Board, the guaranteed maximum cost for the school construction portion was $85.9 million and $7.0 million was allocated for the parking and infrastructure costs for the retail portion. We therefore obtained proceeds that amount to $91.4 million through the COPs issuance, which, along with estimated interest earnings of approximately $4 million, will be used to fund the costs of issuance and District costs (i.e., Environmental and State acquisition costs) as well as the Temple Beaudry contract.

For the first time in the documentary record, the issue of budgeting for "Environmental" costs is raised directly, and the source apparently identified for payment of environmental costs is the principal from the borrowing and the interest acquired from short-term investment of the proceeds of the 1997 issuance of the Certificates of Participation. However, there is no "budget" clearly established by which to allocate these environmental costs *vis a vis* the myriad of other claims to be made on these borrowed funds.

VI. Subsequent Budget Statements For Belmont

The question of source of funds for payment of Belmont-related costs continues to evolve. As Table 6-3 below demonstrates, the Belmont "budget" now contemplates using a significant amount of developer funds, as well as the rental income from the Grand Avenue/7th Street Garage joint venture with Maguire Thomas Partners, to finish Belmont.

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[94] Memorandum from Henry Jones to Ray Rodriguez, dated June 16, 1998, entitled "Belmont Learning Complex - Retail Component." See Exhibit 69.

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TABLE 6-3

Category		Amount
Lease Purchase Funds*	$	62,593,801
Certificates of Participation (including Projected Interest)	$	94,779,152
Maguire Thomas Partners (Rental Income)	$	771,321
Developer Fees	$	18,100,000
General Fund :		
Design and Oversight	$	70,584
Financial Analysis for Negotiations	$	250,000
Legal Expenses	$	2,195,773
Internal Audit Expenses	$	1,901,337
Total Funding Sources	$	180,661,969
Expenditures to Date	$	139,572,588
Encumbrances to Date	$	36,472,206
Total Expenditures and Encumbrances	$	176,044,794

* Includes reimbursement for land purchase price, relocation costs, surveys, architect fees, and costs of preliminary tests

The Internal Auditor was unable to acquire any other document denominated as a "budget" for Belmont, and no such budget is reflected in the LAUSD's automated accounting records.

VII. Expenditures To Date At Belmont

Since April of 1998, at least three statements of Belmont-related expenditure summaries have been created, as summarized in Table 6-4 below.

TABLE 6-4

Budget Categories for Belmont	Budget Used for 1997 Certificates of Participation	Preliminary Expenditure Estimate by the Chief Administrative Officer	Preliminary Expenditure Estimate by the Chief Financial Officer	Latest Expenditure Estimate by the Chief Financial Officer
	April 21, 1998	**July 14, 1999**	**October 7, 1999**	**December 1, 1999**
Land Acquisition	$60,563,737	$60,563,737	$60,563,737	$60,563,737
Appraisal Fees		$280,017	$280,017	$280,017
Escrow Costs		$176,257	$176,257	$176,257
Surveys		$103,285	$108,132	$108,132
Site Support Costs		$1,160,132	$217,042	$217,042
Relocation Assistance		$1,442,394	$1,515,885	$1,515,885
Attorney Fees		$924,713	$937,891	$937,891
Demolition		$401,484	$406,944	$397,044
Architect Fees		$9,636,808	$8,163,405	$6,636,587
Other Planning Costs	$1,500,000	$507,444	$784,192	$791,566
New Construction	$86,310,434	$46,014,734	$78,301,710	$79,642,814
Tests/Inspection		$1,308,096	$2,325,201	$2,325,210
Furniture & Equipment		$2,168	$2,168	$2,168
Rental Property Maintenance		$665,875	$670,675	$670,675
Contingencies				
Belmont Fee Payment	**$292,181**			
Legal Expenses			$2,012,002	$2,195,773
Financing (Certificates of Participation)	$1,297,385		$6,195,802	$6,686,969
Contract Services (Office of Planning & Development)			$543,072	$771,320
Environmental Work	$2,000,000		$7,665,790	$9,903,787
Design Oversight Committee			$22,107	$70,584
Contracts (Internal Audit and Special Investigations)				$1,901,337
Financial Analysis for Negotiations				$250,000
Totals:	**$151,963,737**	**$123,187,144**	**$170,892,030**	**$176,044,794**

VIII. Conclusions Regarding The Budgeting For Belmont

The Internal Auditor has probable cause to believe that the LAUSD Board of Education. Nor did the senior staff, including the Superintendents, Chief Financial Officers or Chief Administrative Officer, ever cause to be created a budget to guide Belmont expenditures and provide for an accounting check on expenditures. Though the Chief Financial Officers (former and present) pointed to environmental matters as a concern that was addressed through their borrowing efforts via the 1997 Certificates of Participation, these LAUSD officials did not cause to be created the proper budget and accounting systems to place in actual effect any provision for the payment of contingent environmental expenses at Belmont.

The Internal Auditor has probable cause to believe that the LAUSD relied upon Mr. Dominic Shambra and his team, including Mr. Raymond Rodriguez, Mr. Wayne Wedin and Dr. Betty Hanson, never caused to be created a definitive budget for the construction of Belmont, thereby individually and collectively failing to provide proper budget and accounting guidance to the LAUSD, particularly with regard to the need of a contingent reserve for environmental issues at Belmont. Mr. Shambra, Mr. Wedin and Dr. Hanson bear particular responsibility for their failure to address the environmental contingency issue in their work with the State Allocation Board.

Further, and on balance in reviewing their various roles and actions at the LAUSD, the Internal Auditor has probable cause to believe that Ernst & Young, though employed by and relied upon by the LAUSD as an expert, failed to identify or recommend financial risk avoidance strategies or other corrective action regarding the financial implications of the environmental remediation issue (whether by way of contingent reserve through the Development and Disposition Agreement or by way of a contingent reserve in LAUSD's own budget, or through the use of environmental insurance), thus failing to meet their professional responsibility to the LAUSD. To the extent that Mr. Shambra, Mr. Wedin and Dr. Hanson, as well as others at LAUSD, relied upon Ernst & Young, that firm failed to provide complete and thorough advice on matters within its competence and actual knowledge.

The professional standards of the American Institute of Certified Public Accountants require the CPA to exercise due professional care in the performance of professional services.[95] Although the Governmental Accounting Standards does not require the integration of a formal budget for capital project funds, they point out that budgetary accounting techniques are an extremely important accounting control aspect.

The Internal Auditor has probable cause to believe that Ernst & Young -- acting in the same time period as the LAUSD audit firm, accountant of record on the LAUSD financial statements used to issue the 1997 Certificates of Participation, and outside real estate financial expert to Mr. Shambra -- knew or should have known that Belmont's environmental situation posed a clear and present danger to the viability of the economic arrangements contemplated and pursed by the LAUSD to pay for Belmont.

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[95] Rule 201 of the American Institute of Certified Public Accountants Code of Professional Conduct.

CHAPTER 7

"BELMONT WAS HANDLED DIFFERENTLY" ANALYSIS OF LAUSD'S BUDGETING AND ACCOUNTING FOR THE BELMONT LEARNING COMPLEX

I. Overview And Findings

In light of the prior analyses by KPMG and Fuller,[96] the Internal Auditor's review of the LAUSD's budgeting and accounting for the Belmont Learning Complex was designed to assess the Belmont financial situation as a test case of the findings by KPMG and Fuller.

This approach involved a two-stage process of analysis. First, utilizing an outside certified public accountant with experience in public school accounting,[97] the Internal Auditor asked for and received from the Chief Financial Officer a written answer to the basic question: "What has LAUSD spent on Belmont?" Following up on this written response, the Internal Auditor then conducted a detailed analysis of the budget and accounting systems to see if the Internal Auditor could recreate the Chief Financial Officer's report. This approach permitted the Internal Auditor's team to test the application of the LAUSD's financial information system through a case-specific analysis. The results were not encouraging, finding a difference of $2,143,964.35 between the Chief Financial Officer's good faith estimate and the results of the Internal Auditor's analysis.

Second, utilizing the services of certified forensic investigators whose prior experience included significant forensic white collar criminal investigation work as agents of the Federal Bureau of Investigation, the Internal Auditor attempted to conduct a forensic review of certain specific Belmont expenditures. In this process, every piece of paper in the payment trail is examined for authenticity and accuracy. These results were also not encouraging, as set forth in detail below.

Using these two methods together, the Internal Auditor could analyze the "system" for structural weaknesses as well as investigate in fundamental detail certain specific allegations as to possible financial misconduct at Belmont. The conclusions are starkly negative.

First, the Internal Auditor found that the LAUSD Chief Financial Officer had extraordinary difficulty, utilizing existing financial management information systems, in answering the basic question: "How much has LAUSD spent on Belmont?" The Chief Financial Officer cannot rely upon a single financial accounting system, and the units in his office (or in other areas of the LAUSD) maintain parallel, though not consistent, sets of accounting records, both automated and manual in nature. Rather than erring by maintaining the proverbial "two sets of books,"

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[96] These two reports are discussed in detail in Chapter 4.

[97] Summerford Accountancy, P.C., Certified Public Accountants & Fraud Examiners, located in Birmingham, Alabama. The Summerford firm had no prior experience with the LAUSD.

LAUSD has an array of accounting methods that collectively do not add up apparently to a single generally accepted set of books.

Second, the ability to commit potential fraud and waste that was predicted by KPMG and Fuller is illustrated by examples from the Office of Planning and Development, the office with specific authority over much of the life of the Belmont project.

Third, while now taking fundamental steps to alleviate these problems, the former and current Chief Financial Officers,[98] as well as the former and current Superintendents,[99] failed to reform this financial accounting system, notwithstanding their significant knowledge of these types of problems. In their defense, however, the financial condition of the LAUSD during the period of Belmont's development (roughly 1990 to 1999) ran from desperate in the early 1990's to merely better by the end of the decade. Both the former and current Chief Financial Officers must be credited with making appropriate requests through the proper LAUSD channels for funds to upgrade the financial management system. However, neither the former and current Superintendents, nor the LAUSD School Boards from July 1995 through July 1999, approved the necessary commitment of funds to alleviate these financial system problems.

II. The LAUSD Financial System – The Internal Auditor's Analysis

A. The Chief Financial Officer's Preliminary Numbers

In response to a written request from the Internal Auditor, on October 11, 1999, LAUSD's Chief Financial Officer, Olonzo Woodfin, presented to the Internal Auditor a preliminary review of sources and uses of funds for the Belmont project (hereinafter the "Woodfin Report").[100] The Woodfin Report outlined where the funds came from to pay for the project and a summary of the amount spent or encumbered on Belmont as of October 7, 1999.

According to the Woodfin Report, expenditures for the Belmont project as of October 7, 1999 totaled $137,364,123, with outstanding encumbrances of $33,527,905, representing a grand total of $170,892,029 spent or encumbered for the project, a significant advance from an earlier, preliminary estimate in July of approximately $123 million.[101]

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[98] Mr. Henry Jones was the LAUSD Chief Financial Officer from 1994 to 1998. Mr. Olonzo Woodfin is the current LAUSD Chief Financial Officer.

[99] Mr. Sid Thompson was Superintendent from 1992 to 1997, when Dr. Ruben Zacarias became Superintendent.

[100] See Exhibit 1.

[101] An earlier, preliminary statement of the expenditures associated with the Belmont Learning Complex had been prepared as of July 14, 1999 by Chief Administrative Officer David Koch, apparently in response to an inquiry by the *Los Angeles Times*. This July estimate of approximately $123 million was the primary "working" number relied upon by the LAUSD, including the Internal Auditor, prior to the Woodfin Report.

B. The Internal Auditor's Methodology To Test These Preliminary Numbers

To test the reliability and accuracy of the Woodfin Report, the Internal Auditor's team requested from the Information Technologies Division ("ITD") an entire backup of the computerized accounting systems for the last ten years. The requested information included all the financial transactions for the LAUSD over this ten year period. This information was downloaded into a separate computer system operated by the Internal Auditor's team for analysis.

From this mass of information, all expenditures referencing the Belmont project in any fashion were reviewed, including looking at vendor files related to the Belmont project on a test basis to see if there were invoices and contracts, and if the resulting expenditures were allocated properly. From this analysis, the Internal Auditor's team created a parallel report to the Woodfin Report, and then examined how these two reports compared and differed. However, this process met numerous obstacles.

1. The Integrated Financial System

The Integrated Financial System, LAUSD's financial information system, was implemented at the beginning of fiscal year 1994. All of the prior years' financial information are maintained on tape media and have been archived. In the opinion of Jacinta Holley, Systems and Programming Manager, the prior years' tapes would not be in good enough condition to be restored. Nonetheless, the Internal Auditor requested ITD to produce the damaged tapes for review regardless of their condition. Upon restoring the tapes, ITD discovered that they could provide the accounts payable portion of fiscal years 1991 through 1993, but could only include the expenditures for this time period. This information was provided to the Internal Auditor on November 9, 1999.[102]

As a result, due to this lack of information from fiscal years 1989 and 1990, the Internal Auditor relied upon the information provided in the Woodfin Report for his analysis.

2. The PICK Report

Part of the information provided in the Woodfin Report was compiled from the PICK system, a stand-alone accounting system that is used by the Facilities Services Division to track capital and other construction project information. Because the IFS system has not yet been fully implemented in the five years since its inception, LAUSD also uses several other stand-alone software packages as well as duplicative manual processes to track detailed information outside of IFS. The PICK system is used primarily by the Facilities Services Division to report timely information for cost and schedule status on LAUSD capital projects.

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[102] ITD also provided a memo stating that the data requested was not deliverable for fiscal years 1989 and 1990. See *First Report of Findings*, Exhibit B. Ennis Davis, Director of Information Systems stated, "the Information Technology Division was not required prior to the 1991/90 fiscal year to retain/archive the data for the Accounts Payable System. Therefore, there are no files to be retrieved to comply with your request."

Information is manually entered into the PICK system from the IFS system. Control totals are then compared to provide assurance that all information has been input. There are several notable weaknesses regarding the use of the PICK system:

- Monies are spent from LAUSD funds other than Capital Project Funds.
- There is an inherent lack of auditability in the PICK system.

The information that is manually entered from the IFS system into the PICK system is pulled from the Project Number in the IFS Project Module. If the IFS user fails to input a project number, the information will not be included in the PICK system, resulting in an unreliable PICK report.

Likewise, the IFS system only requires the input of a Project Number for outlays of cash in the Capital Projects Funds. Thus, if money is spent from the General Fund, as is the case for many of the legal and professional services for the Belmont project, this information will not be included in the PICK report.

Another notable issue regarding the PICK system is the ability to manipulate data, which makes it an unauditable database. Despite this, the PICK report remains the primary source for much of the financial information regarding LAUSD capital projects, including Belmont.

3. The Delay Between Requesting And Receiving Information

Although the time frame allotted to complete this investigation was approximately six weeks, the delay between requesting and receiving information from various sources created an obstacle to the Internal Auditor's investigation.

On October 18, 1999, "all" backup information was requested for the expenditures referenced in the Woodfin Report. Part of the requested information was received on October 28, 1999. The remainder of the information was not received until November 19, 1999.

On October 19, 1999, the download of all the financial information from IFS was initially requested from ITD. The Internal Auditor's team began receiving the download information on a sporadic basis, with the requested final information received only on November 9, 1999.

4. "Belmont Was Handled Differently"

Throughout the investigation, the Internal Auditor's team was repeatedly told that "Belmont was handled differently" than all other capital projects undertaken by the LAUSD. This was the response whether trying to track the budget or expenditures for the project.

LAUSD is required by law to follow the State Department of Education's California School Accounting Manual as well as the Governmental Accounting Standards Board requirements ("GASB"). Although the Governmental Accounting Standards Board does not require the integration of a formal budget into the accounting system for capital projects funds, it is suggested that budgetary accounting techniques are an extremely important control aspect of governmental accounting and serves important managerial information and control purposes. GASB observes that "Judgment should be used in the integration of a budget for capital projects especially where numerous projects are financed through capital project funds."[103] Or in the case of the Belmont project, where funding is provided from several different sources.

Due to the magnitude of the Belmont project, a formal budget should have been integrated into the project's accounting records.[104] Failure to integrate this Belmont budget into the accounting records exposed LAUSD to potential waste and abuse. As observed by the KPMG and Fuller Reports discussed in Chapter 4 above, the results of not integrating a formal budget include:

- Loss of tracking ability as required by the State Allocation Board.
- The ability to spend funds on unplanned expenditures, such as the significant Belmont environmental expenditures.
- Loss of control of expenditures and enforcement of revenue provisions.
- Reconciliation of the sources to the actual uses of funds for the project become cumbersome if not impossible, potentially precluding a complete audit trail.

5. Diversity Of Data

In researching the information provided in the Woodfin Report, the Internal Auditor observed that the Woodfin Report was compiled from different sources. These sources included at least the following three primary systems, each of which utilized data and management information systems in a different fashion:

- The PICK report.
- The IFS System.
- The Office of General Counsel.

This extreme diversity of data lends itself to potential errors and misstatements in management and financial reporting. As the KPMG and Fuller Reports concluded, LAUSD must implement all components of the Integrated Financial System and eliminate the use of stand-alone systems and manual processes immediately if LAUSD is to increase productivity, accuracy and reliability of reporting. If such an implementation is not possible, the IFS system must be replaced by a fully integrated budget and accounting system.

6. The Fiefdoms

During the Internal Auditor's investigation, it was noted that departments within the LAUSD frequently act as stand-alone entities often working with their own policies and procedures, without regard for the ramifications on other departments or the LAUSD as a whole. As the KPMG and Fuller Reports observed, the Internal Auditor also found it extremely difficult to break through each fiefdom to arrive at the actual operations of departments, or to master the policies and procedures they follow (or are supposed to follow). Apparently, not only did departments not know what the other departments were doing, but they appeared not to want to know.

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[103] Governmental Accounting Standards Board Codification Section 1700.118 and 1700.119

[104] This was also Conclusion #5 in the Fuller Report (see Chapter 4).

As observed by the KPMG and Fuller Reports, the implementation and enforcement of clear, updated policies and procedures together with updated information technology will go a long way toward overcoming these fiefdoms. At the risk of over-stating the obvious, all LAUSD departments must work together for the benefit of the LAUSD.

C. The Internal Auditor's Analysis Compared To The Woodfin Report

Following are the results of the investigation of funds expended as of October 7, 1999 for the Belmont project. Although Mr. Woodfin issued an updated Belmont project report as of December 1, 1999, the late date and the lack of supporting documentation made it impossible for the Internal Auditor to review the update in the same manner as given to the original Woodfin Report.[105]

TABLE 7-1

Belmont Learning Center Summary Per Investigation

Pre FY 1991 data per PICK database	223,109.17	
Accounts Payable Pre-IFS FY 1991-1993	1,947,121.24	
Totals for IFS System FY 199 - October 7, 1999	128,222,786.10	
Subtotal Charges Directly to Belmont Orgn 8045 and 8544:	**$130,393,016.51**	
Legal Expenditures Charge to Legal Counsel		
O'Melveny & Myers	1,789,157.55	*
Proskauer Rose LLP	140,693.89	
Legal Source	77,275.25	**
Consultant	45,425.97	*
Baker & Hostetler LLP	129,568.05	
Subtotal Legal:	**$2,182,120.71**	
Financing Costs	**$6,195,802.28**	**
Office of Planning & Development		
Wedin	241,114.14	*
Ernst & Young	189,000.00	*
California Financial Services	236,450.00	
Coopers & Lybrand	15,000.00	
Subtotal OPD:	**$681,564.14**	
Design Oversight Committee	**$70,584.27**	**
Encumbrances	**$33,527,905.94**	**

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[105] As a general matter, it is also important to note that given the short window of time for this investigation, many documents were not reviewed which are nonetheless important.

Additional Belmont Expenditures for Status Report 10/28/99* **	
Dominic Shambra	1,000.00
MV&P International	104,503.09
Kenneth Leventhal & Co.	25,000.00
Ninyo & Moore	350,000.00
Subtotal:	**$480,503.09**
Total Per Investigation	**$173,531,496.94**
The Woodfin Report	**$170,892,029.50**
Status Report 10/28/99	
Dominic Shambra	1,000.00
Coopers & Lybrand	15,000.00
MV&P International	104,503.09
Kenneth Leventhal & Co.	25,000.00
Ninyo & Moore	350,000.00
Subtotal:	**$495,503.09**
Total Per Amended Woodfin Report:	**$171,387,532.59**
Difference	**$2,143,964.35**

* Did not have the opportunity to review all invoices
** Did not have the opportunity to review any backup
*** Reviewed backup documentation provided by Woodfin's office only

In summary, Table 7-1 demonstrates that the Internal Auditor's team found a difference of $2,143,964.35 in expenditures attributable to Belmont as compared to the Woodfin Report (the timeframes examined are the same, so there is no discrepancy due to "timing" issues relating to when data was posted). Rather, the Internal Auditor's analytical exercise demonstrates that the financial information system of the LAUSD is not currently designed nor functioning to answer accurately the most basic of questions – how much has LAUSD spent on Belmont? On December 2, 1999, the Chief Financial Officer presented the Internal Auditor's team with a refinement on the October Woodfin Report. This report represented the Chief Financial Officer's continuing efforts to update and refine the correct "categories" of expenditures on Belmont.

Table 7-2 sets forth all three estimates of expenditures on Belmont – the July, October and December 1999 figures. This table also provides a reconciliation, indicating how these figures have changed over the last five months as the Chief Financial Officer struggles to make the LAUSD financial information system (and the myriad of other accounting techniques spread ad hoc through the various departments and branches) answer the simple yet challenging question of "how much has Belmont cost?"

TABLE 7-2

Budget Categories	**Budget Submitted to SAB for Reimbursement**	**Preliminary Estimate by GAO**	**Preliminary Estimate by CFO**	**Final Estimate by CFO**
	July 14, 1997	**July 14, 1999**	**October 7, 1999**	**December 1, 1999**
Land Acquisition	64,160,692	60,563,737	60,563,737	60,563,737
Appraisal Fees		280,017	280,017	280,017
Escrow Costs		176,257	176,257	176,257
Surveys		103,285	108,132	108,132
Site Support Costs		1,160,132	217,042	217,042
Relocation Assistance		1,442,394	1,515,885	1,515,885
Attorney Fees		924,713	937,891	937,891
Demolition		401,484	406,944	397,044
Architect Fees		9,636,808	8,163,405	6,636,587
Other Planning Costs	5,507,590	507,444	784,192	791,566
New Construction	79,598,600	46,014,734	78,301,710	79,642,814
Tests/Inspection	765,000	1,308,096	2,325,201	2,325,210
Furniture & Equipment	3,013,500	2,168	2,168	2,168
Rental Property Maintenance		665,875	670,675	670,675
Contingencies	2,297,681			
Legal Expenses			2,012,002	2,195,773
Financing (Certificates of Participation)			6,195,802	6,686,969
Contract Services (Office of Planning & Development)			543,072	771,320
Environmental Work			7,665,790	9,903,787
Design Oversight Committee			22,107	70,584
Contracts - Internal Audit and Special Investigations				1,901,337
Financial Analysis for Negotiations				250,000
Totals:	**$155,343,063**	**$123,187,144**	**$170,892,030**	**$176,044,794**

Table 7-2 illustrates the shifting nature of the cost of Belmont, summarizing four different cost estimates created from the summer of 1997 to the end of 1999.

June 1997 – In June of 1997, a budget was prepared by the Shambra-led LAUSD team and presented to the State Allocation Board for partial reimbursement by the State of California.[106] However, this budget represents the LAUSD's best estimate of the likely Belmont costs prior to the actual financing of Belmont via Certificates of Participation issued in December of 1997 (see the discussion of these certificates in Chapter 6).

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[106] This request was rejected. The State previously paid for the land acquisition costs for the 11 acre and 24 acre parcels that now make up Belmont.

July 1999 – The Chief Administrative Officer, responding to a request from the *Los Angeles Times*, prepared an estimate of Belmont's actual costs through that time. The total figure of approximately $123 million was the primary cost figure used by the Internal Auditor in his first *Report of Findings*.

October 1999 – The Chief Financial Officer's estimate for the Internal Auditor was the first time LAUSD had attempted a comprehensive, exhaustive analysis of actual Belmont costs across the entire LAUSD system. Five new expenditure categories captured for the first time the legal and financing costs of Belmont, as well as other directly related costs from Mr. Shambra's office.

December 1999 – The last estimate prepared by the Chief Financial Officer and made available to the Internal Auditor demonstrates that through the end of November 1999, the total cost of Belmont had reached approximately $176 million, including the land acquisition costs and subsequent out-of-pocket expenditures on Belmont by the LAUSD.

Table 7-3 sets forth the differences between the October and December 1999 Belmont expenditure estimates. These differences total $5,152,764. While certain increases for further construction, continuing environmental work and legal fees (principally to the O'Melveny & Myers firm and the Proskauer Rose firm) are understandable, the significant decrease in architectural fees applied to Belmont remains unexplained. And, of course, the costs of the Internal Auditor's various Belmont investigations must now be attributed to the overall cost of Belmont.

TABLE 7-3

Budget Categories	Difference Between Oct./Dec. 1999	% Difference Between July/Oct. 1999
Land Acquisition	0.00	0%
Appraisal Fees	0.00	0%
Escrow Costs	0.00	0%
Surveys	0.00	0%
Site Support Costs	0.00	0%
Relocation Assistance	0.00	0%
Attorney Fees	0.00	0%
Demolition	-9,900.00	-2%
Architect Fees	-1,526,818.00	-19%
Other Planning Costs	7,374.00	1%
New Construction	1,341,103.00	2%
Tests/Inspection	9.00	0%
Furniture & Equipment	0.00	0%
Rental Property Maintenance	0.00	0%
Contingencies	0.00	0%
[redacted]	0.00	0%
Legal Expenses	183,771.00	9%
Financing (Certificates of Participation)	491,166.00	8%
Contract Services (Office of Planning & Development)	228,248.00	42%
Environmental Work	2,237,997.00	29%
Design Oversight Committee	48,477.00	219%
[redacted]		
Contracts - Internal Audit and Special Investigations	1,901,337.00	
Financial Analysis for Negotiations	250,000.00	
Totals:	**$5,152,764.00**	3%

D. LAUSD – Systemic Issues

During the analysis of the Woodfin Report and review of the funds expended for the Belmont project, several systemic issues were noted. While they may not necessarily relate to Belmont alone, the Internal Auditor believes that they confirm the overall conclusions reached in the KPMG and Fuller Reports, and deserve reporting here, for they demonstrate serious weaknesses in the LAUSD's financial control systems.

1. Direct Payments

IFS has a control feature which requires a reference to a contract or a purchase order when posting a disbursement to a vendor. The purpose of this control is to reduce the risk of overpayment and/or improper or unauthorized payments. An override can be performed in the system to circumvent this control feature, allowing what is referred to as a Direct Payment. The Internal Auditor was told that there are circumstances that would warrant a management authorized override. These circumstances would include amended contracts that have not been processed through the system.

In the event that an override is performed on a contract or a purchase order allowing a Direct Payment to a vendor, the amended contract should be reduced by the amount of the Direct Payment to prevent overpayment of the contract or purchase order. This is not always the case. While it is not unusual for an accounting system to allow an occasional override to a control feature, the Internal Auditor observed that Direct Payments are prevalent in the IFS system. In fact, three alarming situations were noted:

- Overpayment of Contracts.
- Outstanding encumbrances of $77,832,786 from fiscal years 1993 through 1998.[107]
- Vendors paid by Direct Payment.

2. Overpayment Of Contracts

A paradigm of this problem of potential overpayment of valid contracts is the story of Dr. Betty Hanson of California Financial Services, a Belmont vendor that was in fact improperly overpaid on contract CS950378.[108] This contract, issued on January 24, 1995 for $20,000, was amended for an additional $50,000 on July 26, 1995. Two invoices, FEB1996A and MARCH96 were submitted for payment 8 months following the amended contract date. However, the amended contract had not been processed through the system so the invoices were paid by Direct Payment.[109]

The California Financial Services vendor file contained one approved override for invoice FEB1996A. There was no evidence of an approved override for invoice MARCH96. The overrides paid to California Financial Services totaled $11,325.

After the amended contract was entered into the IFS system, the accounting department failed to properly adjust the amount by reversing the Direct Payment. The effect of reversing the Direct Payment would be to reenter the payment against the contract's open purchase order, reducing the available funds for future expenditures. Consequently this resulted in the total payment on the contract of $81,325 (an overpayment of $11,325).

In addition to the IFS system and other stand-alone software packages utilized by the LAUSD, the Accounts Payable Department uses a manual ledger card system (referred to as a Payment Record Card) for each vendor with a valid contract. The purpose of the Payment Record Card is to track all payments made against the contract and any change orders applied to the contract, thus in theory, providing a current remaining balance for the contract. The Accounts Payable Clerk makes a manual entry to the Payment Record Card each time there is a payment, a contract change order, or a contract amendment. Thus, there are at least three separate systems to track payments, possibly others in departments not reviewed.

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[107] See Exhibit 4

[108] See Exhibit "5"

[109] Additional discussion regarding investigation of California Financial Services. See infra p. ___.

While this procedure appears to be duplicative, repetitive and cumbersome in nature, Howard Kaplowitz, Head Accountant, explained that it is a necessary approach, since the IFS system cannot track change orders. Unfortunately, as demonstrated here in the case of California Financial Services, the Payment Record Card system failed to detect the overpayment of the California Financial Services contract. Based on the Internal Auditor's review, numerous instances were discovered where changes were not tracked, leaving the LAUSD open to overpayments, confirming the worst fears expressed in the KPMG and Fuller Reports.

The inability of the IFS system to effectively track the remaining balance on a contract is a serious flaw in the internal control system of the LAUSD.[110] Although manual procedures have been put in place to help alleviate any potential problems, in a school district the size of LAUSD, these manual procedures are simply inadequate and counterproductive. The amount of time required of the staff to manually keep up with payments makes this procedure extremely expensive in labor. Furthermore, as observed by this example of the overpayment to California Financial Services, the system does not always work.

3. Outstanding Encumbrances

In a budgetary accounting system such as the LAUSD's, expenditure estimates in the annual budget are appropriated by category and should constitute the maximum expenditures authorized during the fiscal year, and cannot be exceeded unless amended. When a contract is accepted or a purchase order is issued, a commitment has effectively been made against the budget and the funds are encumbered against those appropriations, thus reducing the remaining amount available for future expenditures.

At LAUSD, when Direct Payments are made to a vendor and not applied against the outstanding contract or purchase order, the funds in the budget have essentially been tied up twice. This is not to say that they have been spent twice, although there is evidence of that as described above regarding California Financial Services. Rather, the funds have been tied up as follows: (1) by the encumbrance of the contract or purchase order, and (2) by the Direct Payment, which is applied to the unencumbered appropriations that are remaining for future expenditures.

The Internal Auditor's investigation discovered that **the outstanding encumbrances from fiscal years 1993 through 1998 total $77,832,786.** These are funds now reserved in fund balances for subsequent year expenditures. However, because in many instances these contracts have actually been completed by way of Direct Payments, much of this $77 million dollars will never be spent.

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[110] However, according to Fred Lising, Director – General Accounting, IFS does in fact have the ability to track the change orders. However, this particular capability of IFS has never been implemented.

Howard Kaplowitz, Head Accountant, acknowledged that old encumbrances are a problem, but he did not realize they totaled in excess of $77 million until informed of that number by the Internal Auditor's team. Fred Lising, Director – General Accounting, also acknowledges the outstanding encumbrance problem, but was not surprised at the amount discovered by the Internal Auditor. Indeed, Mr. Lising did not consider it a big problem.

Perhaps more troubling, however, is the fact that there is no reference to the outstanding encumbrances in Note A of the Comprehensive Annual Financial Report, "Summary of Significant Accounting Policies." The outstanding encumbrances amount continues to grow each fiscal year and represents a serious weakness with the internal controls. The weaknesses allow for:

- Overstatement of outstanding encumbrances on the financial statements.
- Overpayment of contracts.
- Allowances for reallocation of the budgeted funds.

4. Vendors Paid By Direct Payment

In reviewing the Belmont vendor payments, the Internal Auditor discovered that there were many vendors who were paid **only** by Direct Payment. Examples of these vendors include two law firms who performed significant Belmont-related work:

- Baker & Hostetler LLP - $1,347,889
- Proskauer Rose LLP - $1,565,844

The Payment Record Cards on these vendors showed approvals by Richard Mason, LAUSD's General Counsel. There were, however, no contract totals against which to track for possible overpayments.

There were other vendors noted who were paid both by Direct Payments as well as being paid against a purchase order or contract:

O'Melveny & Myers
Direct Payments - $6,045,376
Contract Payments - $2,930,850

Ernst & Young
Direct Payments - $709,573
Contract Payments - $1,398,669

There is ample opportunity to circumvent system controls by manipulating the procedures for vendor payments, notwithstanding not-to-exceed budgets. Such manipulation reduces the ability to track payments through the computer system, and again opens the system to potential manipulation, waste and even fraud.

5. Contract Payment Accruals

The LAUSD utilizes an encumbrance system for all budgeted funds (except Proprietary and Fiduciary Funds) to reserve portions of applicable appropriations for which commitments have been made. Encumbrances are recorded for purchase orders, contracts and other commitments when they are written. Encumbrances at year-end do not constitute expenditures or liabilities.[111] The LAUSD's policy, however, is to recognize the expenditure and corresponding liability if performance on a contract is complete, or virtually complete, and there is an invoice in the approval process. This procedure closes the purchase order but enables the future expenditures to be tracked through the Integrated Financial System.

According to procedures as described by the Information Technology Division, when the invoice is posted to the system it is referenced against the accrual entry for future tracking purposes in the Accrual Screen of IFS, which will reference the transaction with an "AV" in the Reference ID field.

The Internal Auditor traced several accrual entries through IFS and a "JV" was found in the Reference ID field where procedure dictated they have an "AV" reference. The ITD department was unaware of why this would happen. ITD referred to their procedural manual and were unable to find any reference regarding the use of a "JV" entry.

This same question was deferred to Ed Suastegui, Accounting System Specialist. Mr. Suastegui stated that although not a written policy, this procedure has been in practice for the last several years.

While time did not permit a complete investigation regarding the closing of payment accruals to a "JV" entry, several questions regarding the internal control of the IFS procedures and the ease with which these controls can be circumvented must be addressed:

- The Accrual Screen in IFS was created to track the payments made against accrued balances. The tracking ability is only valid if it is used as intended with an "AV" entry. A "JV" entry eliminates all tracking ability.
- If the accrual procedure is being conducted only when there is an invoice in the approval process, it should stand to reason that the accrued funds would be paid out shortly after fiscal year end, thus alleviating any reason for the Journal Entry one to two years later.
- The ability to reallocate budgeted funds for other purposes provides both the opportunity and the ability to misappropriate funds.

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[111] Governmental Accounting Standards Board Codification Section 1700.129.

6. Miscellaneous Vendors

During a review of vendors, the Internal Auditor discovered more than 20 miscellaneous identification codes could be used to pay vendors. More disturbing, **the Internal Auditor discovered that actual payments made to these codes totaled $71,082,591, and included payments to more than 10,000 actual vendors from July 1993 through October 1999. Payments made to these codes ranged from $1 to $5,400,000.**

According to LAUSD procedures, three offices were originally authorized to update the Vendor Table: Accounts Payable, Purchasing, and Stock Accounting. The authority was later removed from Accounts Payable and Stock Accounting due to the frequency of duplicate vendor codes.

The intent of the new procedure was to increase internal control on the issuance of vendor codes. Rather than forcing these departments to follow the new procedures, the system was circumvented and miscellaneous vendor codes were used for ease and simplicity. While this approach clearly makes sense for non-repetitive reimbursements of employee out-of-pocket expenses, or occasional reimbursements to parents for funds advanced on valid school activities, this approach is highly questionable when used to make repetitive payments to a standard vendor.

While the use of miscellaneous identification codes is not abnormal in practice, the frequency and high dollar values used in the above mentioned miscellaneous identification codes dramatically raises a red flag. Abuse of the vendor codes increases the chance of:

- Fictitious vendors.
- Duplicate payments.
- Competitive bidding policies not being followed.
- Inability to track vendor history.

This Belmont review did not allow for an investigation of payments applied to all of these vendor codes. Clearly, however, the Internal Auditor recommends strongly that the LAUSD's Chief Financial Officer investigate payments made using these codes.

7. Budget Transfers

The Internal Auditor, while reviewing the Capital Projects Funds, discovered that in Fund 073 that Al Southwood, Administrative Services Manager, Facilities Services Division, made individual budget transfers in the amount of $49,999 on 48 separate occasions between September 1998 and January 1999. Twelve of the transfers were from Object 6209 to Object 6210. The remaining thirty-six were transfers from Object 5805 to Object 6210.

According to the LAUSD's Board of Education policy, management has the authority to make routine transfers of budget appropriations between major categories within a Fund for no more than $50,000. Transfers greater than $50,000 require Board approval. Furthermore, Bulletin No. 36 dated May 19, 1995, from the LAUSD Budget and Financial Planning Division, defines transfers of more than $50,000 into or out of Major Object 6000 (Capital Outlay) as "non-routine" Budget Adjustments and such transfers will be brought to the Board for approval.[112]

As has been demonstrated by the LAUSD repeatedly, internal controls have once again been circumvented. Without further investigation, it is difficult to say that there has been any wrong doing by these budget transfers; however, repeated transfers just below the approved limit raises questions as to the intent of the transferring party.[113]

8. Closing

It is the Internal Auditor's opinion that the cost of the Belmont project as disclosed in the Woodfin Report cannot be relied upon to give an accurate cost of the project. The Internal auditor's calculated total cost of the Belmont project shows a difference of over $2.1 million. However, due to the systemic weaknesses in the LAUSD, the Internal Auditor is of the opinion that the cost the Internal Auditor developed can also not be relied upon. Several steps must be completed before anyone can arrive at reliable numbers as to the cost of the Belmont project:

- Direct Payments must be reconciled to all outstanding encumbrances.
- Adjustments resulting from the Direct Payment reconciliation must be made to the records.
- Overpayments to vendors (which may have been made in areas other than Belmont) should be reviewed.
- Payments and supporting documentation must be reviewed.

With regards to the systemic issues of the LAUSD, we recommend the following:

- Implementation of a financial system that will do away with the need for stand-alone software packages and manual processes. If IFS is not capable of this, then another financial system should be implemented as soon as possible.
- Implementation and enforcement of clear, updated policies and procedures.
- A mechanism to insure that all departments work together for the benefit of the LAUSD.

Echoing both the KPMG and Fuller Reports, the Internal Auditor concludes that these issues must be addressed immediately. Failure to do so will continue to breed an environment susceptible to fraud, waste and abuse.

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[112] See first *Report of Findings*, Exhibit "E"

[113] See Exhibit "F"

III. The Limited Forensic Review

A. Methodology

During the investigation of Phase II, the financial phase, of the Belmont project, the Internal Auditor received at least two boxes of documents that had been mysteriously found by a school employee, which should have been turned over to the Internal Auditor during the first phase.

On October 19, 1999, the Internal Auditor sent a written request to the Chief Financial Officer, Olonzo Woodfin, identifying approximately fifty-three specific vendors for contracts, records of payments, payment warrants (what the general public would consider checks), invoices, and other documents related to payments to various vendors associated with the Belmont project. The Internal Auditor's team selected a representative sample of twenty-two persons or companies identified as vendors who were paid for Belmont related services, according to reports generated by the LAUSD Accounting Department. The remaining thirty-one vendor names provided to the Chief Financial Officer had been identified as related to Belmont during the Internal Auditor's prior Belmont I investigation. The deadline for the production of these documents was October 26, 1999.

B. Accounts Payable Section, Business Accounting Branch

The LAUSD Accounts Payable Section ("Accounts Payable") responded initially to the Internal Auditor's October 19 request. Their response came in the production of two forms of records: (1) "manual records of payments files," and (2) "warrants" (also labeled "district voucher copy") attached to which were invoices supporting the payment of the warrant. Accounts Payable produced certain files/folders relating to only twenty-seven of the fifty-three requested vendors.

The Internal Auditor's team initially found that files for certain vendors, though listed on the Accounting Department printout that payments had been made related to Belmont, nonetheless contained no indication (at least in the files produced) that they had any connection to Belmont. Upon further inquiry by the Internal Auditor's team, Accounts Payable explained that there were no other files for these particular vendors. Such a claim is inconsistent with LAUSD policy, since school policies and procedures provided to the Internal Auditor's team indicate that a copy of CS004 (which is an invoice for payment) must be sent to Accounts Payable prior to any payment to a vendor[114].

Each manual record of payment file provided by Accounts Payable was reviewed by the Internal Auditor's team for any information of value and for general observations. The types of documents kept in the files were inconsistent. Some files held copies of contracts or certain pages thereof, extensions of contracts or certain pages thereof, invoice approval forms, vendor invoices, and various correspondence.

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[114] See the LAUSD Contract Handbook, Chapter 3 at page 17; see also "Personal and Professional Services," LAUSD Contract and Insurance Services Branch, September, 1996, with Appendix and incorporated Bulletin No. 4 issued by the Business Services Division on September 1, 1994, and related updates to the handbook. Exhibit 9.

Accounts Payable also began producing warrants to the Internal Auditor's team a few at a time, and in no particular order, by either warrant number or vendor. A warrant/check stub was furnished for each payment. Attached to the warrant stub was the original, or a copy of the original invoice. Often one warrant was issued to pay more than one invoice. A representative sampling of the invoices were reviewed by the Internal Auditor's team.

However, Accounts Payable was unable to produce a printout of all payments made to the requested fifty-three vendors listed on the October 19 memo to Mr. Woodfin. This was apparently caused by various changes in the computerized accounting systems, which were not compatible with each other for producing such a report.

On November 1, 1999, the Internal Auditor sent a written request to the Environmental Health and Safety Branch and the Real Estate and Asset Management Branch for all contracts for fifty-three (53) contractors and consultants engaged to work on the Belmont project. The information was requested no later than November 12, 1999.

When it became apparent that a complete review of the selected vendors files and warrants would not be possible within the time limits of the investigation, the scope of the inquiry was limited to a smaller representative sampling of eleven vendors. A written request was sent to the Chief Financial Officer with copies to Environmental Health & Safety Branch, Real Estate and Asset Management Branch and the Chief Operating offices on November 5, 1999 by the Internal Auditor, with a request to those LAUSD units to discontinue research on the larger group and to concentrate on the eleven target vendors. The production of records was to be completed no later than November 10, 1999.

Over a period of days and weeks thereafter, documents continued to be received from Accounts Payable by the Internal Auditor. However, it was not possible to make reliable reviews of all contracts and payments because no complete listing of all payments to the eleven vendors was ever received by the Internal Auditor's team.

However, the Internal Auditor's review of the files and documents provided by the Accounts Payable Section provides a basis for some general observations.

1. Confusion In The Audit Trail

The accounting process, and the resultant paper trails, are a conglomeration of various programs and policies developed and changed over the years. Accounts Payable uses various codes and nomenclature, sometimes with more than one name for an item, but most often using meaningless names (*e.g.*, area, organization, program, object, and sub-object) to an outside auditor (or even to staff auditors). The result is that it is nearly impossible to follow a trail of accountability through its entire process.

- A double system of bookkeeping records was observed. There is a "manual record of payment" and a computerized record. The Internal Auditor did not conduct an audit to determine whether such systems differ in content. The Internal Auditor's staff commented that the manual records were initiated when computers were first used and the accounting staff "didn't trust it (the computer system)" and the practice was never stopped.

- There is no continuity in Accounts Payable files. They differ in basic content from vendor to vendor. Sometimes copies of contracts and/or purchase orders are found, sometimes not. Sometimes original invoices are found, sometimes not. Sometimes copies of invoices are found, sometimes not. Sometimes approvals from appropriate managers are present, sometimes not. Invoicing is inconsistent and often non-descriptive. A representative sample of such invoicing might show "Services for January, 1995" as the work was completed.

- Payment for invoices is slow and inconsistent, resulting in extra time spent by Accounts Payable in auditing prior payments against prior invoices and time spent by various departments responding to vendor inquiries and complaints.

- The Internal Auditor found that Accounts Payable personnel spend a lot of time checking the minutiae of invoices. This may result in the discovery of some inappropriate charges, but it is time consuming and costly to the LAUSD. Internal LAUSD contracting units are responsible for insuring that invoices submitted by vendors are in accordance with the LAUSD Contract Handbook and with overall LAUSD policy.

- A review of the warrant stubs often showed no direct tie to a contract or purchase order. A multi-step system, through a "document number" is required. Despite observations made in the Internal Auditor's first report on Belmont, a lack of cooperation from District departments continued to be the rule rather than the exception.

- Requests were made to the Office of Public School Construction for reimbursement of legal expenses related to Belmont which may not have been appropriate and which suggest a failure to follow proper cost allocation on the part of the District.[115]

- Evidence was found that contracts were signed without properly encumbering funds because such funds were in "a deficit."[116]

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[115] Letter to Michael Scinto, LAUSD, from Office of Public School Construction dated March 21, 1995. See Exhibit 10.

[116] Per a memorandum dated September 16, 1996 sent to all LAUSD schools and offices, LAUSD Business Manager David Koch admonishes that, "State law and LAUSD policy do not allow independent contractors to begin work until their contracts have been approved." (Example, ABB Environmental working on Park Avenue School receiving an amended extension without executing the original contract.) See Contracts Handbook attachments for a copy of the September 16, 1996 memo. See Exhibit 9.

- A memo was found in a file to request that a warrant be issued for services rendered, with payment from one or the other of two separate contracts, and be hand delivered to the school sponsor rather than mailed to the vendor. (See footnote No. 38.)

- Accounting for legal services was especially problematic. Attorneys billed for Belmont project work under a "General Counsel" agreement and also billed for other matters under the Belmont project contract.[117] Many invoices from attorneys were impossible to cost allocate because different projects were listed all together, yet approved for payment by the LAUSD General Counsel.[118] An invoice from O'Melveny & Myers LLP, approved by the General Counsel, was found to be in disarray in the Accounts Payable warrant documents. These costs were allocated by Michael DeLuca, Deputy Director. The Internal Auditor's review revealed that four of the projects had no purchase order but were marked for payment by Mr. DeLuca anyway.[119]

- Howard Kaplowitz, Head Accountant, did a "year-end budget override" memo to "avoid the accrual process which becomes necessary if the over-budgeted invoices are not paid."[120]

- On invoices, approval and supporting documents, there are signatures and initials that are illegible or unidentifiable and have neither a printed or stamped name or title with them. No dates appear with signatures. There is no way to tell if they were even on a list of persons authorized to approve the invoice, or if such a list even exists.[121]

- Changes are handwritten on a memo relating to invoices of, and funds related to, vendors (an invoice for O'Melveny & Myers is an example) without a clear indication as to who made the changes.[122]

- Vendors were paid an amount titled "per payment schedule" which was not attached to documents found in the warrant documents.[123] See Exhibit 18.

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[117] Proskauer invoice dated March 29, 1999 and O'Melveny & Myers (OMM) invoice dated October 31, 1998. See Exhibit 12.
[118] Mike DeLuca memo dated December 19, 1995 to Mei Ginn. See Exhibit 13.
[119] OMM documents attached to LAUSD Voucher Copy (Warrant) No. 27550904 dated December 14, 1995 regarding payment to OMM. See Exhibit 14.
[120] Memo from Howard Kaplowitz to Fred Lising, Director, dated May 8, 1998 titled "Year-End Budget Override". See Exhibit 15.
[121] LAUSD Contract Payment Certificate for Environmental Strategies Corp. dated August 25, 1999. See Exhibit 16.
[122] Memo from Richard K. Mason to Howard Kaplowitz dated November 14, 1995. See Exhibit 17.
[123] LAUSD Voucher Copy (warrant) No. 20172261 dated August 15, 1997 regarding payment to Community Partners. See Exhibit 18.

- Invoices were submitted and paid with little explanation of services rendered,[124] including possible excessive charges for a tank and clarifier extraction that included a total of five change orders.[125]

- Various vendors provided invoices to the school district with inadequate descriptive information regarding services rendered.

- In one instance, an LAUSD employee was told to encumber against one of two project numbers, 1028 or 1029, "whichever has money."[126]

2. Allegations Of Misconduct At The Office Of Planning And Development

In addition to problematic issues with regard to Belmont accounting documents, the Internal Auditor also examined specific allegations of financial misconduct within the Office of Planning and Development when Mr. Dominic Shambra was the Director of that Office. Three specific contractors' records were requested from the Contract Section, Business Services Branch, and reviewed by the Internal Auditor's team:

- Wedin Enterprises.
- California Financial Services.
- Temple Beaudry Partners.[127]

According to Ms. Thais Rothman, Contract Supervisor,[128] authority for contract approval has been delegated by the LAUSD Board of Education to the Contract and Insurance Branch at various times to include specific dollar amounts that may be approved by that Branch, including:

- January 14, 1991: $15,000 personal and professional service contract limit allowed by Section 20111 of the Public Contracts Code.

- June 17, 1991: Limit increased to $50,000.

- June 25, 1992: Authority extended to Facilities, Planning and Real Estate Branch for special services contracts (pursuant to Government Code 53060), including architectural services and real estate transactions.

- June 20, 1994: Authority for contracts increased to $100,000 for personal and professional service and special services contracts.

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[124] Invoice for Payment for Services Rendered Under Personal or Professional Services Contract (Form CS004), relating to Community Partners, signed on August 7, 1997. See Exhibit 19.

[125] Invoice to Los Angeles Unified School LAUSD, attn: Richard Lui, dated December 24, 1997, from Remedial Management Corporation. See Exhibit 20.

[126] See handwritten note on the Work Authorization No. 3, effective May 4, 1999, signed by Elizabeth Louargand. See Exhibit 21.

[127] See Chapter 5 for the discussion of Temple Beaudry Partners.

[128] Rothman interview, supra.

- September 2, 1997: Authority for Contract and Insurance Services Branch (personal and professional service contracts) reduced to $50,000.

- July 13, 1999: Authority for Contract and Insurance Services Branch (personal and professional service contracts) increased to $100,000.

Following this review of the records, an interview was conducted with Ms. Thais Rothman, Contract Supervisor, regarding the contracting process in general and the Belmont vendor contracts in particular.[129] She also provided the Internal Auditor's team with a variety of internal LAUSD documents which updated or changed policies and procedures outlined in the LAUSD Contract Handbook. Basically she said that the Contract Section is a service group, rather than an oversight group, which seeks to accomplish the business of the school district, whether the provisions set out in the contract handbook are followed or not. Rather than bind the LAUSD to uniformity in preparing contracts, it is apparent that personnel at Contract Services tend to facilitate the generation of a contract rather than following the guidelines found in the Contract Handbook.[130]

However, procedures regarding the use of Contract Section ("CS") forms as outlined in the Contract Handbook and related memos and bulletins regarding the use of CS forms were infrequently followed.[131] Contract Section personnel had problems getting appropriate and timely responses from contract sponsors. Board approval of certain projects relating to contracts was poorly documented. The work to be completed under an amendment/extension to a contract was often entirely different than that outlined in the original contract. Established procedures were frequently ignored and procedural overrides were made at the direction of the legal and/or accounting departments. Certain forms (CS006 - Independent Contractor Checklist) are filed centrally by vendor number to be used in conjunction with all contracts by that vendor rather than in the specific contract file. Contracts are issued by several branches/divisions of the school district. There is no central location, repository, or database for contracts. Work is often started, and sometimes completed, before contracts are approved by the Board and no follow up documentation is entered into the file to explain the discrepancy.[132]

In one particular case, Law/Crandall completed environmental work that was not described in its geotechnical contract.[133] The work was subsequently authorized by LAUSD for environmental work, but still under the geotechnical contract.[134]

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[129] Interview of Thais Rothman on November 9-10, 1999.

[130] Documenting this view, personnel in the Contract Section were always cooperative and responsive to the questions and requests of the Internal Auditor's team.

[131] See, for example, California Financial Services contract No. 950378, as compared to Bulletin No. 4, dated September 1, 1994, regarding the procedures in effect at the time that contract was signed. See Exhibit 22.

[132] Rothman interview, supra, and Karen Hemingway interview dated November 9, 1999.

[133] Law Crandall contract No. 965201, Barbara Rachal letter dated March 19, 1996, and Law Crandall invoices for environmental services for contract No. 965201. See Exhibit 23.

In another case, the outline for a contractor's "Mitigation of Site and Disbursal of Funds," regarding financial obligations, was not followed with regard to the 24 acre portion of Belmont.[135] In yet another case, the vendor spent more than the amount specified in the contract.[136]

a. Wayne Wedin, Doing Business As Wedin Enterprises, Inc.

Since 1987, LAUSD has contracted with Wayne Wedin and/or his Wedin Enterprises, Inc. approximately fourteen times, with several of these contracts having extensions or amendments, almost always under the sponsorship of Mr. Dominic Shambra. The School District and Mr. Wedin could not provide all the documents related to all of these contracts and payments.[137] The Internal Auditor, however, reviewed available documents and found a number of discrepancies in billing and payments.

For example, an invoice sent to Dominic Shambra failed to reflect adequate descriptive information as to dates and specific work performed. The "Date" was shown as "Various" and the description of the work was "Overall research and contact with developer community." A total of forty hours were billed in this fashion on this one invoice.[138]

Charges for work done on various types of projects, some possibly reimbursable from the state, such as " . . . housing and mixed use" and "Work on housing and retail combination with schools" and "Meeting re: . . . schools and housing" were shown on the same invoice.[139] Contracts were apparently extended to cover charges for work done under a previously authorized limit.[140] Invoices approved by Shambra had Wedin contract numbers changed.[141]

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[134] The Contract Section uses the "Mapper" database, which is duplicative of information contained within other databases within LAUSD, but is not interconnected with these other systems. As a result, the Mapper database is often ineffective and outdated in application. For example, the Internal Auditor's team was unable to identify a specific Law Crandall contract because when the contract was entered into the system, two spaces (instead of one) were entered between "Law" and 'Crandall."

[135] Outline for Mitigation of Site and Disbursal of Funds, undated, found in a folder relating to Intera. See Exhibit 24.

[136] Three page letter to Richard Lui from Richard Spivak of Duke Engineering, dated November 6, 1997. See Exhibit 25.

[137] Some of these records were destroyed pursuant to normal LAUSD record retention policies.

[138] Invoice dated May 6, 1987, addressed to Dominic Shambra and signed by Wayne D. Wedin. See Exhibit 30.

[139] Invoice dated April 16, 1991, addressed to Dominic Shambra and signed by Wayne D. Wedin. See Exhibit 31.

[140] Richard K. Mason memo to Thais Rothman dated October 6, 1993, and Wayne Wedin memo to Elaine Danny, dated October 18, 1993. See Exhibit 32.

[141] Memo from Dominic Shambra to Howard Kaplowitz dated August 14, 1996 with attached Wedin invoice No. 080296 and memo dated September 18, 1996 with attached Wedin invoice No. 090296. See Exhibit 46.

LAUSD's General Counsel took steps to have Wedin's contract renewed without providing proper documentation nor identifying the contract.[142] LAUSD General Counsel also ordered the Chief Accountant to do a "budget override" in order to pay Wayne Wedin.[143] The Chief Accountant approved the payment.[144] Contracts Section continued to have problems with the Wedin contracts during June 1996 and had to ask Legal Counsel for clarification of authorization.[145] Mr. Wedin complained directly to the General Counsel regarding problems with contracts and payments, and the General Counsel personally saw to it that the matter was handled.[146]

A $75,000 contract for Wedin Enterprises, Inc. was signed by a Contract Supervisor without doing an IFS encumbrance.[147] Improper accounting practices seem to have been further ordered by the Chief Accountant, causing additional problems because of a deficit in an account.[148]

On one occasion, the Chief Financial Officer approved an over-ride on Wedin Contract No. 950077.[149] On another occasion, Mr. Shambra requested a warrant be issued to Wedin Enterprises, Inc. stating that payment had been authorized "in accordance with LAUSD Contract No. 950077, or new Contract No. 960124" indicating that Shambra did not know to what contract the specific payments should be charged. He also ordered that the payment be delivered to "Deloris" and "PLEASE DO NOT MAIL TO WEDIN." There was no explanation why it was not to be mailed.[150] Curiously, Mr. Wedin managed to bill the school district for work done on Christmas Day 1995.[151] Mr. Wedin also billed the school for a mix of Belmont costs and non

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[142] Memo from Richard Mason to Thais Rothman, dated November 18, 1993. See Exhibit 33.

[143] Memo from Richard Mason to Fred Lising, dated January 26, 1994. See Exhibit 35.

[144] Memo from Richard Mason to Fred Lising, dated January 26, 1994, with handwritten notes. See Exhibit 35.

[145] Two page memo from S. Thais Rothman to Richard Mason dated June 14, 1996. See Exhibit 45.

[146] Wedin memo to Rich Mason dated October 12, 1996 and Mason memo to the Board of Education and the Superintendent dated October 17, 1996, with attached documents (Bates stamped numbers IA-00332 through IA-00336). See Exhibit 47.

[147] Memo from Thais Rothman to Fred Lising dated March 1, 1994. See Exhibit 36.

[148] Memo from Thais Rothman to Rich Mason dated March 16, 1994. See Exhibit 37.

[149] Handwritten note showing a date of August 29, 1995. See Exhibit 38.

[150] Memo from Dominic Shambra to Howard Kaplowitz dated September 27, 1995. See Exhibit 39.

[151] Invoice No. 010396 from Wedin Enterprises addressed to Dominic Shambra dated January 7, 1996. See Exhibit 41.

Belmont costs on the same invoice as late as March 5, 1996,[152] June 4, 1996[153] and June 28, 1996.[154]

Mr. Shambra, as late as August 1997, continued to make, or caused to be made, handwritten changes to contract numbers and amounts shown on Wedin invoices.[155]

Based upon these facts, the Internal Auditor has probable cause to believe that Mr. Shambra failed to exercise sufficient supervision and control over the activities of Mr. Wedin, to the point that it is not possible to document accurately the value of services delivered to the LAUSD by Mr. Wedin.

b. Dr. Betty Hanson Of California Financial Services, Inc.

Mr. Dominic Shambra, while the Director of the Office of Planning and Development, recruited Dr. Betty Hanson to be a consultant to his office.[156] The Internal Auditor's review disclosed that there were a total of five Belmont-related contracts identified for California Financial Services, Inc., the corporate entity that employed Dr. Hanson. The Internal Auditor does not believe that all documents were provided. A review was conducted of available documentation. A detailed review of contract No. 950378 was conducted with available documents, and the Internal Auditor has no reason to believe that this contract was not indicative of the other California Financial Services contracts.

Mr. Shambra initiated contact with the Contract Section in October, 1994 to have a contract written for Dr. Betty Hanson, doing business as California Financial Services, to be effective

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[152] Invoice No. 030296 from Wedin Enterprises addressed to Dominic Shambra dated March 5, 1996. See Exhibit 42.

[153] Invoice No. 060296 from Wedin Enterprises addressed to Dominic Shambra dated June 4, 1996. See Exhibit 43.

[154] Invoice No. 070296 from Wedin Enterprises addressed to Dominic Shambra dated June 28, 1996. See Exhibit 44.

[155] Memo from Dominic Shambra to Howard Kaplowitz dated August 10, 1997 regarding Contract No. 970348 and attached Wedin invoice No. 0601297A and Memo from Dominic Shambra to Howard Kaplowitz dated August 10, 1997 regarding Contract No. 970349 and attached Wedin invoice No. 0601297. See Exhibit 48.

[156] After recruiting Dr. Hanson to the LAUSD, Mr. Shambra apparently disclosed to the LAUSD General Counsel that at some point in the employment of Dr. Hanson, Mr. Shambra and Dr. Hanson began a personal relationship. According to Mr. Shambra, the General Counsel advised Mr. Shambra that it was not a conflict of interest for Mr. Shambra to supervise Dr. Hanson's work. Dr. Hanson informed the Internal Auditor's team that she did not do any further work or bill the LAUSD for work after this disclosure was made, which she alleges occurred in August of 1997. The Internal Auditor was unable to determine with any specificity the sequence of these events in order to confirm the accuracy of these representations, but did confirm that Dr. Hanson was paid through 1998 on invoices received after August of 1997. The admitted and disclosed personal relationship between Mr. Shambra and Dr. Hanson created, at a minimum, the appearance of a conflict of interest in these matters.

September 1994. Because standard CS forms were not issued by Mr. Shambra's office, the Contract Section had problems with Mr. Shambra and/or his staff getting the appropriate information they needed to accomplish the task. Contract No. 950378, for $20,000, was not ratified by the LAUSD Board of Education until November 21, 1994. The contract was not signed by California Financial Services until at least January, 1995 and was not encumbered by Accounts Payable until February 1995, with a "date of order 1-24-95."[157]

Dr. Hanson submitted an invoice on this contract reflecting work done and charges for work done as far back as September 1994. That invoice was sent to Mr. Shambra by Dr. Hanson in January 1995, and was approved for payment by Mr. Shambra on January 26, 1995.

The same contract was then amended and extended from December 31, 1995 to June 31, 1996 and increased from $20,000 to $70,000. The extension was made so Hanson could be a consultant to another LAUSD office for purposes of working to obtain Federal Emergency Management Agency funding for hazard mitigation following the Northridge earthquake. The contract addition was ratified by the LAUSD Board on September 18, 1995. The amended contract became highly controversial, in that the work outlined to be done in the contract, according to those to whom Dr. Hanson was assigned to work, was already being undertaken by existing school district employees, who opposed the retention of Dr. Hanson on those grounds.[158]

Invoices for this work showed billing for meetings with school officials on at least one day, December 29, 1995,[159] which is shown on school schedules as an employee holiday.[160]

Beyond this specific contract, other documents found in certain Accounts Payable folders reflected that LAUSD contracted with Dr. Hanson (as California Financial Services) on five separate contracts from 1995 through 1998. The amount of the contracts, with extensions and amendments, totaled $245,000. There was insufficient documentation provided by Accounts Payable regarding payments to California Financial Services to calculate, with certainty, the total amount of money paid to that firm through the typical county warrant system. However, as discussed, supra, a separate "Selected Vendors Expense Report" was obtained from ITD which reflected that California Financial Services was paid a total of $256,325 from February 15, 1995, through July 22, 1998, indicating a likely overpayment of $11,325 as compared to Dr. Hanson's contracted $245,000.[161] This ITD report, however, did not list warrant numbers, but rather listed "document" numbers from which a separate investigation would have to be made to identify the warrant numbers involved. The Accounts Payable department never did produce to the Internal Auditor's team a printout of total payments made to California Financial Services.

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[157] "California Financial Services contract No. 950348. See Exhibit 22.

[158] Interview of Margaret A. Fairlie on November 18, 1999 and Memorandum from Dr. Betty Hanson to Dominic Shambra, dated March 16, 1995. See Exhibit 71.

[159] Record of Work Activities for Contract with California Financial Services and Los Angeles Unified School LAUSD (invoice) dated December, 1995 and approved for payment by Dominic Shambra on or about 1-10-96. See Exhibit 28.

[160] Los Angeles Unified School LAUSD Payroll Calendar 1995-96. See Exhibit 29.

[161] The sum of $11,325 was confirmed, then, independently by the Summerford firm as well as the former FBI agents Wisdom and Wight.

CHAPTER 8

PAYMENTS TO CONSTRUCTION CONTRACTORS

The Internal Auditor has probable cause to believe that the developer, construction contractor, and some subcontractors have submitted payment applications that constitute overbilling. The following narrative is a description of specific examples and observations regarding the payment record for specific contractors and the performance of consultants retained to review contractor payment applications. These findings implicate possible violations of the California False Claims Act.

I. Overbilling By Developer And Construction Contractors

The Belmont project was constructed by general contractor, Turner/Kajima Construction, which is a joint venture between Kajima Construction Services, Inc. and Turner Construction Company. Turner/Kajima Construction has a general contractor's contract with the developer Temple Beaudry Partners. Kajima Construction Services, Inc. is a related company of Kajima Urban Development LLC, which is the managing partner of Temple Beaudry Partners. Turner/Kajima Construction in turn has entered into contractual arrangements with the subcontractors, who provide specific construction material and skilled labor.

Recently, the LAUSD has retained outside professionals and a project manager to review the payment applications submitted by Temple Beaudry Partners to LAUSD. LAUSD consultants continue to review the payment applications submitted by subcontractors and the general contractor Turner/Kajima Construction, Joint Venture. The Internal Auditor has probable cause to believe that six subcontractors at the Belmont construction site have overbilled the LAUSD by approximately $2,080,148 since project inception. This finding is represented in Table 8 below:

TABLE 8
SUB-CONTRACTORS THAT POTENTIALLY OVERBILLED LAUSD FOR WORK DONE ON THE BELMONT PROJECT

SUB-CONTRACTOR	PAY APPLICATION DATE	ESTIMATED AMOUNT PAYABLE	AMOUNT BILLED	AMOUNT DIFFERENCE (Estimated Overbilling)
Winegardner	07/31/99	2,960,725	3,444,325	483,600
Rucker Tile	07/31/99	120,000	221,072	101,072
KHS&S Contractors	07/31/99	4,964,859	5,439,990	475,131
BMP Group	07/31/99	868,764	1,360,000	491,326
Queen City Glass Co.	07/31/99	360,000	418,059	58,059
Downey Electric Inc.	07/31/99	4,918,424	5,449,430	531,006
TOTAL ESTIMATED AMOUNT OVERBILLED				**$2,080,148**

The overbilling was the result of primarily two factors: (1) an inadequate LAUSD payment application review process and (2) a conscious decision by contractors at the Belmont construction site to submit inaccurate payment applications, which were inaccurate to the financial detriment of LAUSD but inured to the financial benefit of the contractor and subcontractors submitting the payment applications. The inaccurate, overbilling payment applications were submitted by Turner/Kajima Construction and Temple Beaudry Partners to LAUSD.[162]

In the following discussion, the Internal Auditor will describe the specific examples of overbilling that have been brought to his attention during the course of this investigation. The subcontractors identified below do not constitute an exhaustive list, and the amount of overbilling may include a larger number of subcontractors.

A. Winegardner Masonry

Winegardner Masonry ("Winegardner") is a subcontractor hired to provide "masonry" for school construction. On July 31, 1999, Turner/Kajima Construction submitted payment application no. 28 to Temple Beaudry Partners ("July Payment Application"). A payment application is submitted to Temple Beaudry Partners which in turn submits the payment application to LAUSD for actual payment. In the July Payment Application, Turner/Kajima stated that Winegardner Masonry had earned $3,344,325 since project inception, including $682,615 during the month of July. Winegardner also submitted a payment application no. 12 to Turner/Kajima indicating that Winegardner had earned and was entitled to payment of $3,344,325 through the time period covered by the July Payment Application.

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[162] Alternatively, "overbilling" is characterized as "front-end loading" because the contractor bills for labor and material not yet provided.

LAUSD consultants called into question the amount billed by Winegardner in the July Payment Application. On October 18, 1999, Winegardner indicated to Turner/Kajima Construction that, in Winegardner's own opinion, it had overbilled the LAUSD by $354,418. In a letter dated November 18, 1999, Temple Beaudry Partners submitted a Revised July Payment Application. In a letter dated November 16, 1999, Turnér/Kajima Construction adjusted its payment application for the Winegardner work to request payment of $2,960,725 for the period of time through July 31, 1999, instead of the $3,444,325 originally submitted by Winegardner.

As a result of the above, the Internal Auditor has probable cause to believe that Winegardner overbilled the LAUSD by $483,600 from project inception through the July Payment Application. Adjustments to this request were only made after LAUSD consultants investigated and demanded the adjustment.

B. Rucker Tile

Rucker Tile ("Rucker") is a subcontractor hired to provide "ceramic tile" for school construction. Within the July Payment Application, as described above, Turner/Kajima Construction originally showed that Rucker was entitled to a payment of $221,072. The Rucker payment application to Turner/Kajima Construction showed that the payment application detail consisted of $7,500 for labor and approximately $213,500 for materials.

After LAUSD consultants requested additional back up for the payment application, Temple Beaudry Partners sent a letter attaching Rucker material invoices in support of the July Payment Application. The amount of these supporting invoices totaled $102,740.68 instead of the $213,000 requested. In a letter dated November 18, 1999, Temple Beaudry Partners submitted a Revised July Payment Application. In a letter dated November 16, 1999, Turner/Kajima Construction adjusted its payment application for the Rucker work to request payment of $156,116 for the period of time through July 31, 1999, instead of the $221,072 originally submitted by Rucker.

As a result of the above, the Internal Auditor has probable cause to believe that Rucker overbilled the LAUSD by approximately $101,000 in the July Payment Application. With approximately $7,500 of labor performed and a cost of $102,740 for material provided, the Internal Auditor believes that a reasonable mark-up of materials provided would consist of $120,000. Adjustments to this request were only made after LAUSD consultants investigated and demanded the adjustment.

C. Keenan, Hopkins, S&S

Keenan, Hopkins, S&S ("KHS&S") is a subcontractor hired to provide "drywall/E.I.F.S." for school construction. Within the July Payment Application, as described above, Turner/Kajima

Construction originally showed that KHS&S had earned and was entitled to a payment of $5,439,990 since project inception, including $1,017,051 earned during the month of July. The KHS&S payment application to Turner/Kajima Construction demanded payment of $5,439,990 since project inception through the period ending July 31, 1999.

LAUSD consultants called into question the amount billed by KHS&S since project inception in the July Payment Application. Specifically, on October 18, 1999, KHS&S indicated to Turner/Kajima Construction that in KHS&S's own opinion it had overbilled the LAUSD by $203,929, and it was entitled to only $793,122. On October 26,1999, Turner/Kajima Construction sent a letter to Temple Beaudry Partners indicated that KHS&S had, in addition to the overbilling described above, overbilled the LAUSD in change order "A-1" by $70,000.

In a letter dated November 18, 1999, Temple Beaudry Partners submitted a Revised July Payment Application. In a letter dated November 16, 1999, Turner/Kajima Construction adjusted its payment application for the KHS&S work to request payment of $4,964,859 for the period of time through July 31, 1999, instead of the $5,439,990 originally submitted by KHS&S. The resubmitted pay application acknowledges that the overbilling was in Temple Beaudry Partners', Turner/Kajima Construction's and KHS&S' position $475,131 and reduces the amount earned by KHS&S through July 31, 1999 accordingly.

As a result of the above, the Internal Auditor has probable cause to believe that KHS&S overbilled the LAUSD by approximately $541,920 through the period covered in the July Payment Application. Adjustments to this request were only made after LAUSD consultants investigated and demanded the adjustment.

D. BMP Group

BMP Group ("BMP") is a subcontractor hired to provide "cast in-place concrete" for school construction. Within the July Payment Application, as described above, Turner/Kajima Construction originally showed that BMP had earned and was entitled to a payment of $1,360,000. The BMP payment application to Turner/Kajima Construction demanded payment of $1,360,000 from project inception throught the period ending July 31, 1999.

LAUSD consultants called into question the amount billed by BMP in the July Payment Application and discussed and estimated overbilling of $491,326. On October 26, 1999, Turner/Kajima Construction sent a letter to Temple Beaudry Partners indicated that BMP may have overbilled the project by $79,000.

In a letter dated November 18, 1999, Temple Beaudry Partners submitted a Revised July Payment Application. In a letter dated November 16, 1999, Turner/Kajima Construction did not adjust its payment application for the BMP work, even though Turner/Kajima Construction has acknowledged that BMP may have overbilled LAUSD by at least $79,000. The Internal Auditor has reasonable cause to believe that the remaining work to be performed by BMP cannot be completed for the amount remaining in that Budget.

As a result of the above, the Internal Auditor has probable cause to believe that BMP overbilled the LAUSD by approximately $491,326 from project inception through the July Payment Application. Adjustments to this request have not been made after LAUSD consultants investigated and demanded the adjustment, and Turner/Kajima Construction appeared to agree with at least a portion of the requested adjustment.

E. Queen City Glass

Queen City Glass ("Queen City") is a subcontractor hired to provide "glazing and storefront" for school construction. Within the July Payment Application, as described above, Turner/Kajima Construction originally showed that Queen City had earned and was entitled to a payment of $418,059, including $41,349 earned during the month of July. The Queen City payment application to Turner/Kajima Construction demanded payment of $418,059 for the period ending July 31, 1999.

LAUSD consultants called into question the amount billed by Queen City in the July Payment Application. On October 26,1999, Turner/Kajima Construction sent a letter to Temple Beaudry Partners indicated that Queen City may have overbilled the project by an estimated $53,349.00.

In a letter dated November 18, 1999, Temple Beaudry Partners submitted a Revised July Payment Application. In a letter dated November 16, 1999, Turner/Kajima Construction adjusted its payment application for the Queen City work downward to $394,129. The Internal Auditor has reasonable cause to believe that Queen City has not earned more than $360,000.

As a result of the above, the Internal Auditor has probable cause to believe that Queen City overbilled the LAUSD by approximately $58,059 in the July Payment Application. Adjustments to this request were made only after LAUSD consultants investigated and demanded the adjustment.

F. Downey Electric

Downey Electric, Inc. ("Downey") is a subcontractor hired to provide "electrical and technology" for school construction. Within the July Payment Application, as described above, Turner/Kajima Construction originally showed that Downey was entitled to a payment of $5,224,874. A subsequent revision to the Payment Application indicated that Downey had actually earned $5,449,430, including $877,415 earned in the month of July. The Downey payment application to Turner/Kajima Construction demanded payment of $5,449,429 for the period ending July 31, 1999.

LAUSD consultants called into question the amount billed by Downey in general and in the July Payment Application. Specifically, on October 13,1999, Downey faxed a letter to Turner/Kajima acknowledging that the change order that Downey had billed as $250,974, after challenged by LAUSD consultants was in fact only $17,750.00 complete. Therefore, the Internal Auditor has probable cause to believe that Downey acknowledged overbilling of $223,224.

In a letter dated November 18, 1999, Temple Beaudry Partners submitted a Revised July Payment Application. In a letter dated November 16, 1999, Turner/Kajima Construction adjusted its payment application for the Downey work downward to $4,918,424. Temple Beaudry Partners had originally stated that Downey had earned $5,449,430.

As a result of the above, the Internal Auditor has probable cause to belief that Downey overbilled the LAUSD by approximately $531,006 in the July Payment Application. Adjustments to this request were made only after LAUSD consultants investigated and demanded the adjustment.

II. Misuse Of Allowances By Construction Contractors

Within the framework of the Disposition and Development Agreement, certain allowances were identified for Turner/Kajima in addition to the Turner/Kajima subcontractor agreement allowances. In the case that the allowance work is required, the subcontractor, contractor and developer must provide the necessary documentation to indicate the reasonableness of the payment request to the LAUSD. The Internal Auditor has been informed that the manner in which allowances have been charged for the project may have impacted the Guaranteed Maximum Price buyout savings and the manner in which the allowance has been incorporated into the schedule of values may make it impossible for the LAUSD to realize the buyout savings or hold the contractor to the actual cost of the work.

These allowances, by and large, are for what would be considered general conditions/requirement costs and should be carried by the General Contractor and/or Construction Manager as specific line items in the general conditions budget. These costs should not be (at least for budgeting and schedule of values purposes) transferred to the subcontractors.

Additionally, the Internal Auditor has reason to believe that most of these items should not be "allowances" at all and should be either guaranteed or not to exceed line items. As "allowances" any cost increases are paid for by the LAUSD, which is not appropriate.

A. GMP Buyout Considerations:

According to the manner in which the Disposition and Development Agreement has been structured, the cost savings as determined after "buyout" of the project is split between the LAUSD and Developer, Temple Beaudry Partners. The first 70% of the "buyout" savings go to the LAUSD and potentially one-half of the remaining 30% of the "buyout" savings go to the LAUSD as well.

By moving these general conditions and requirements costs of the general contractor Turner/Kajima, and costs to the subcontractors as allowances, the value of those subcontracts is increased which results in a reduction to the "buyout" savings.

For example if the Disposition and Development Agreement stated budget for stone work was $1,000,000 and ABC Company bid the work at $800,000 there would be a $200,000 "buyout" savings for that line item to be used in determining the "buyout" GMP. The practice on this project however has been for Turner/Kajima to have ABC Company include $60,000 of allowances in its price to cover overall project general conditions costs. As such the ABC Company enters into a subcontract for $860,000 instead of $800,000 thereby giving the appearance that the "buyout" savings are only $140,000.

This methodology costs the LAUSD between 70% and 85% of the $60,000.00 reduction in "buyout" savings which is considerable especially when this sort of methodology is used on approximately $4,000,000 of supposed allowances. It is possible that there could be a seven-figure impact (over $1 million) on the GMP buyout savings, considering the fact that there are over $4 million of such allowances and deductive alternatives in the various subcontractors, many of which are for duplicate scopes of work.

B. Schedule Of Values Considerations:

In all but a few cases the "allowances" are not identified in the subcontractor schedules of value and segregated from actual scope of work activities so that the costs against the allowances could be properly and easily tracked. Instead the allowances are commingled with the scope of work activities so that they are billed for as part of the hard cost of the work whether or not work has actually been performed for the allowances.

The Internal Auditor has reasonable cause to believe that virtually all cases involving the use of "allowances" will lead to overbilling of the activities for which the subcontractor is requisitioning each month.

III. Outside Consultants Retained To Review Construction Contractor Payment Applications

A. Hanscomb, Inc.

Under an agreement executed November 3, 1997, Hanscomb, Inc was hired by LAUSD to perform an initial 45-day, pre-construction phase cost assessment of the Belmont project. That assessment encompassed the following scope of work: (1) detailed opinion of probable project costs based upon a review of existing documentation including the Disposition and Development Agreement, design drawing and specifications, Geotechnical reports and studies, the developer's (Temple Beaudry Partners) estimates assembled for its lump sum bid, and LAUSD financial and cost studies; (2) comparative reconciliation report between the developer's lump sum estimates and Hanscomb's opinion of probable costs; and (3) value engineering workshop on project design. Under the agreement, Hanscomb was retained to also provide construction phase oversight. In the construction phase, Hanscomb was charged with providing: (1) periodic review of developer's invoices for contractual acceptability, adherence to industry standards and to the Disposition and Development Agreement; (2) explain Temple Beaudry Partners invoicing exceptions; (3) provide a monthly report detailing the basis for payments to Temple Beaudry Partners; (4) review all claims submitted for reasonableness of associated costs; (5) review claims to determine additions or deductions from project scope; (6) prepare final report of value engineering recommendations; and (7) review and analyze Temple Beaudry Partners's payment schedule of values with regard to value of individual work components.

Early in the Hanscomb/LAUSD contractual relationship, there were indications that the objectives of the contract were being frustrated because of the non-responsiveness of certain LAUSD personnel and the passive methodologies employed by Hanscomb to achieve the objectives outlined in the consultant. One major impediment to bringing the cost assessment objectives to fruition was outlined in Hanscomb Vice President David Chau's December 31, 1997 letter to Facilities Manager, Elizabeth Louargand[163] explaining the need for a current payment schedule of value for the Belmont project. A schedule of value is a document that details the work provided by each subcontractor.

Mr. Chau said that he had discussed the payment schedule of value with Elmond Wan, project manager of Turner/Kajima on the Belmont project. His understanding from Mr. Wan was that they still did not have a schedule of value prepared for this project, and the budget established by their office earlier in the year did not correctly reflect the value of individual trades from the current design. The December 31, 1997 letter indicated that Hanscomb planned on using the budget allowances in the GMP as the starting point and develop the payment schedule of value from the accepted bid packages as the project progressed. In the same letter, Mr. Chau admitted Hanscomb's inability to review or analyze Turner/Kajima's payment schedule and indicated that as an alternative Hanscomb had prepared an attached copy of a payment schedule which was based on their own design development estimates and Turner/Kajima's GMP budget allowances. In the absence of the long-overdue, Turner/Kajima Payment Schedule of Value, Hanscomb suggested that its estimated mock-up schedule was the best way to monitor the contractor payment schedule for the Belmont project at that time.

In his Project Status Report No. 12 – January 1999, dated February 19, 1998,[164] Hanscomb project manager Gregory Kobzeff related ongoing problems Hanscomb was experiencing with regard to the LAUSD not transferring and sharing project change orders and other pertinent documentation in a timely manner. Kobzeff said that procedures for the processing and approval of Change Orders was discussed at a May 27, 1998 meeting held at the District's main offices. The meeting was attended by the LAUSD Project Managers, Rodger Friermuth and Raymond Rodriguez, Owner's Representative and representatives from their Accounting Department, as well as representatives of the Developer, the Contractor and Hanscomb. Kobzeff went on to say that Hanscomb, Inc. had yet to see a formal Change Order Status Log, nor had they been advised with regard to any other pending or potential Change Orders that may have existed at the time of the status report. Additionally, up until that date, Hanscomb had not taken part in any change order review meetings and had only been forwarded copies of "approved" Change Orders subsequent to review, approval, and processing by the District.

Despite the obvious dismay expressed with LAUSD's recurring inefficiency with providing project change orders and other documentation, after meeting with LAUSD's on-site representative, in the same letter Hanscomb supported the project management procedures employed by consultant Daniel, Mann, Johnson & Mendenhall during the months of January and February. In contrast to the lack of document coordination cited in several of its Project Status

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[163] See Exhibit 51.

[164] See Exhibit 52.

Reports, Hanscomb noted that LAUSD's on-site representative was involved full-time in all progress and special contractual meetings, was kept "in the loop" regarding requests for information, design build construction plan changes and clarifications, shop drawings and submittal approvals, and enjoyed a close professional relationship with the Contractor/Developer and Inspection team.

In Project Status Report No. 13 – February 1999, dated March 9, 1999, in Paragraph B, Claims,[165] Hanscomb project manager Gregory Kobzeff restated the problems they were experiencing by not receiving Change Order and backup information from LAUSD for review and assessment until after approvals had already been made. Hanscomb did not receive requested Change Orders Nos. 01 through 05 until January 19, 1999 and had requested, but to date not yet received Change Orders and supporting documentation for Change Order Nos. 06 through 08 which according to the on-site representative had already been approved by LAUSD.

As a result of his investigation of the Belmont project contractor compliance, the Internal Auditor has probable cause to believe that Hanscomb, Inc. did not adequately fulfill its contractual obligations to LAUSD in the construction phase as set forth in its consultant contract. An audit of Hanscomb's performance under this contract illustrated discrepancies in the cost assessment methodology employed by Hanscomb and the objectives of the consulting contract.

B. Daniel, Mann, Johnson & Mendenhall

Under an agreement executed August 27, 1997, Daniel, Mann, Johnson & Mendenhall ("DMJM") was hired by LAUSD to provide "Owner's Representative Services" for the Belmont project. Under this consultant contract DMJM's tasks and responsibilities included: (1) monitoring and reporting job progress, review construction quality elements, review architecture/engineering submittals, review monthly payment applications; (2) review inspection testing reports and verify the work of testing laboratories; and (3) review coordination between the contractor and architecture/engineering, monitor and report on design and construction progress, attend subcontractor meetings, actively participate in value engineering meetings and provide regular progress reports on the project.

In a October 8, 1997 letter to Ken Reizes of Kajima Urban Development, and copying Dominic Shambra, Project Coordinator Raymond Rodriguez introduced Paul Hurley as the DMJM-assigned and LAUSD-accepted on site Owners Representative and while referencing the Disposition and Development Agreement, detailed DMJM's responsibilities with specificity.[166]

As provided in the Disposition and Development Agreement section 1.12 and section 4.2, the Owners Representative was assigned the responsibility of coordinating with Temple Beaudry Partners during the construction process, attending progress meetings and reviewing the status of construction progress. Additionally the Disposition and Development Agreement requires the Owner's Representative to review and approve all developer payment requests.

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[165] See Exhibit 53.

[166] See Exhibit 50.

In a July 30, 1997 letter to LAUSD Board President Julie Korenstein, Senator Tom Hayden expressed his concern over consultant Daniel, Mann, Johnson & Mendenhall being selected to oversee construction of the Belmont project as Owner's Representative.[167] Saying that DMJM lacked the independence to oversee the project and citing a 1996 audit by the Metropolitan Transportation Authority, Hayden pointed out that DMJM had itself been blamed for $1.9 million in overbilling by passing on its out-of-state costs to the MTA. In addition Hayden said that the same MTA audit uncovered $234,000 in overbilling by Jenkins/Gales & Martinez, a firm associated with DMJM on the Belmont Cluster Repair Project and other projects for LAUSD.

In an August 19, 1997 inter-office memorandum to Superintendent Ruben Zacarias, Facilities Manager, Elizabeth Louargand referred to the school board's recent resolution regarding construction manager for Belmont Project and offered two options for the board's consideration, both recommending DMJM as construction manager.[168] In reference to Senator Hayden's July 30, 1997 letter of concern, Louargand sought to reassure the Board about DMJM stating that Dominic Shambra's staff was not involved in the RFP process nor the decision to assign DMJM to the Belmont cluster. Board members Korenstein and Tokofsky also had reservations about DMJM. Appearing to champion DMJM, Louargand closed her letter with the hope that DMJM's letter to Zacarias regarding Senator Hayden's letter would remove some of the Board's concerns.

As a result of his investigation of the Belmont project contractor compliance, the Internal Auditor has probable cause to believe that DMJM, Inc. did not adequately fulfill its contractual obligations to LAUSD during the construction phase as set forth in its consultant contract. An audit of DMJM's performance under this "Owner's Representative Services" contract illustrated discrepancies in the procedures employed by DMJM and the results it obtained.

C. O'Melveny & Myers

Mr. David Cartwright, as a partner in the law firm of O'Melveny & Myers LLP, by written memorandum dated December 9, 1998, instructed the LAUSD to relax its normal accounting procedures in tracking the expenditures by the developer, contractor and sub-contractors at Belmont. This remarkably ill-conceived advice prompted the Facilities Division to unwisely reduce their vigilance in assuring that all costs presented to the LAUSD for payment by the developer, contractor and sub-contractors were proper, accurate and lawful. This advice was relied upon by LAUSD, a fact known to Mr. Cartwright, who knew or should have known that such advice, if relied upon by LAUSD, constituted an invitation to potential waste, fraud and abuse, in a manner ultimately resulting in actual overbilling of LAUSD by certain sub-contractors.[169]

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[167] See Exhibit 54.
[168] See Exhibit 55.
[169] See Exhibit 72.

CHAPTER 9

FINDINGS AND RECOMMENDATIONS

I. FINDINGS

A. LAUSD Board Of Education And Senior Staff Did Not Place Sufficient Priority On Financial Management From 1995 To 1999.

1. The 1995-1997 And 1997-1999 LAUSD School Boards Did Not Place Sufficient Priority On Financial Management.

The former LAUSD School Boards (particularly the 1995-1997 and 1997-1999 School Boards) did not place sufficient priority on the LAUSD financial management systems. Notwithstanding that the period from 1995 to 1999 was a time of relative increases in budget dollars available to the LAUSD, these School Boards did not invest in the necessary enhancements to the Integrated Financial System to make that system responsive and adequate to the LAUSD's needs to keep reliable, transparent and auditable accounting records.

The former LAUSD School Boards (particularly the 1995-1997 and 1997-1999 School Boards) also did not take sufficient steps to ensure that LAUSD staff (1) required and supervised an actual budget for Belmont, including environmental financial contingencies; (2) integrated that budget into the overall LAUSD accounting structure; and (3) supervised actual Belmont expenditures.

2. The Former And Current LAUSD Superintendents Did Not Place Sufficient Priority On Financial Management.

Sidney A. Thompson, LAUSD Superintendent through the summer of 1997, and Dr. Ruben Zacarias, the current Superintendent, did not place sufficient priority of the LAUSD financial management systems. Notwithstanding that the period from 1995 to 1999 was a time of relative increases in budget dollars available to the LAUSD, these Superintendents did not act upon the requests of their respective Chief Financial Officers to invest in the necessary enhancements to the Integrated Financial System to make that system responsive and adequate to the LAUSD's needs to keep reliable, transparent and auditable accounting records.

Mr. Thompson and Dr. Zacarias also did not take sufficient steps to ensure that LAUSD staff (1) required and supervised an actual budget for Belmont, including environmental financial contingencies; (2) integrated that budget into the overall LAUSD accounting structure; and (3) supervised actual Belmont expenditures.

3. The Former Chief Administrative Officer Did Not Supervise The LAUSD In A Manner That Created A Reliable Financial Management System.

The former Chief Administrative Officer, Mr. David Koch, did not exercise sufficiently diligent supervision of the LAUSD financial management systems. Notwithstanding that the period from 1995 to 1999 was a time of relative increases in budget dollars available to the LAUSD, Mr. Koch did not act upon the requests of their respective Chief Financial Officers to invest in the necessary enhancements to the Integrated Financial System to make that system responsive and adequate to the LAUSD's needs to keep reliable, transparent and auditable accounting records.

Mr. Koch also did not exercise sufficiently diligent supervision of the LAUSD in (1) requiring and supervising an actual budget for Belmont, including environmental financial contingencies; (2) integrating that budget into the overall LAUSD accounting structure; and (3) supervising actual Belmont expenditures. In particular, the estimate of expenditures prepared by Mr. Koch in July 1999, though stating that the estimates were only preliminary, nonetheless omitted any estimate of environmental expenditures at Belmont. In fact, Belmont-related environmental expenditures stood in excess of $7 million at that time.

4. The Former And Current Chief Financial Officers Have Not Created Or Maintained A Reliable Financial Management System, And Did Not Exercise Diligent Supervision Of The LAUSD Financial Management Systems.

Henry Jones, the former Chief Financial Officer, and Olonzo Woodfin, the current Chief Financial Officer, did not, in their own opinions, maintain reliable financial management systems. While they both attempted to obtain the necessary financial resources to reform the situation, including funds to upgrade the automated Integrated Financial System, the actual functioning of the various financial accounting systems, both automated and manual, did not (individually and collectively) conform at all times with generally accepted public school accounting standards. The current Chief Financial Officer's good faith yet difficult efforts to answer the basic question of "what has the LAUSD spent on Belmont to date" is dramatic proof of the failure of these financial information systems, which upon auditing by the Internal Auditor's team cannot even confirm the accuracy of the Chief Financial Officer's good faith estimates.

B. The Office Of Planning And Development Personnel Failed The LAUSD On Belmont.

1. Mr. Dominic Shambra, Former Director Of The LAUSD's Office Of Planning And Development, Failed To Exercise Diligent Supervision Over Belmont Budgeting And Expenditures.

Mr. Dominic Shambra, while Director of the LAUSD's Office of Planning and Development, failed to supervise the outside consultants and further failed to prepare the proper records to permit the LAUSD to maintain generally accepted accounting records on the expenditures of his Office. His behavior raises questions of whether there were payments made for work not performed by certain of these outside consultants, including Mr. Wayne Wedin and Dr. Betty Hanson. While Mr. Shambra admitted and disclosed to the LAUSD General Counsel that he had developed, during the course of her employment with the LAUSD, a personal relationship with Dr. Betty Hanson, their respective positions of supervisor and subordinate raise the appearance of a conflict of interest, notwithstanding the General Counsel's apparent oral statements to

Mr. Shambra that no actual conflict existed. In concert with an apparent overpayment of $11,325 to Dr. Hanson's employer, coupled with Mr. Wedin's failure to submit required annual reports and remarkable ability to work on holidays, Mr. Shambra appears to have failed to exercise the proper fiduciary responsibility he owed the LAUSD in his supervision of his Office.

Mr. Shambra also failed to exercise the proper fiduciary responsibility he owed the LAUSD in his supervision of his Office by (1) failing to develop an informed environmental contingency budget; (2) failing to require an environmental contingency element either in the Disposition and Development Agreement or on the LAUSD's own books; and (3) failing to establish a basis on which to seek reimbursement from state and/or local bond funds.

The Internal Auditor has probable cause to believe that Mr. Shambra must bear the ultimate responsibility as the senior LAUSD official directly responsible for the current Belmont situation. Notwithstanding the poor performance of his developmental, educational, legal and financial consultants, or the poor execution by his own supervisors (including the Board of Education) of their own oversight responsibilities, everyone contacted by the Internal Auditor's team inside and outside of the LAUSD looked to Mr. Shambra to guide the Belmont project to success. The Internal Auditor believes that Mr. Shambra failed the children, staff and taxpayers of the LAUSD with regard to his performance on Belmont. In light of that failure, LAUSD must take steps to prevent another Belmont from ever happening again, lest the potential for waste, fraud and abuse overtake the ability of the LAUSD to prevent it.

2. Mr. Raymond Rodriguez, Former Senior Member Of The LAUSD's Office Of Planning And Development, Failed To Exercise Diligent Supervision Over Belmont Budgeting And Expenditures.

Mr. Raymond Rodriguez, as the senior employee after Dominic Shambra in the LAUSD's Office of Planning and Development, failed to coordinate that Office's activities, including the activities of the outside consultants. Mr. Rodriguez further failed to prepare the proper records to permit the LAUSD to maintain generally accepted accounting records on the expenditures of that Office. His behavior raises questions of whether there were payments made for work not performed by certain of these outside consultants, including Mr. Wayne Wedin and Dr. Betty Hanson.

Mr. Rodriguez also failed to exercise the proper fiduciary responsibility he owed the LAUSD in his coordination of this Office's activities by (1) failing to develop an informed environmental contingency budget; (2) failing to require an environmental contingency element either in the Disposition and Development Agreement or on the LAUSD's own books; and (3) failing to establish a basis on which to seek reimbursement from state and/or local bond funds.

3. Dr. Betty Hanson And California Financial Services Overbilled The LAUSD

The Internal Auditor has probable cause to believe that Dr. Betty Hanson and/or California Financial Services, Inc., overbilled the LAUSD for $11,325.

4. Mr. Wayne Wedin Failed To Document His LAUSD Work Properly

The Internal Auditor has probable cause to believe that Mr. Wayne Wedin, while a consultant to the Office of Planning and Development, failed to provide required reports, both by activity and on an annual basis, as required by the LAUSD. Further, Mr. Wedin did not describe his work sufficiently to justify the payments he received from LAUSD, though they were approved for payment by Mr. Dominic Shambra.

5. Ernst & Young Breached Its Duty Of Professional Care To LAUSD

The Internal Auditor has probable cause to believe that Ernst & Young, though employed by and relied upon by the LAUSD as an expert, especially by the Office of Planning and Development, failed to identify or recommend financial risk avoidance strategies or other corrective action regarding the financial implications of the environmental remediation issue (whether by way of contingent reserve through the Development and Disposition Agreement or by way of a contingent reserve in LAUSD's own budget, or through the use of environmental insurance), thus failing to meet its professional responsibility to the LAUSD. To the extent that LAUSD personnel and consultants such as Mr. Shambra, Mr. Wedin and Dr. Hanson relied upon Ernst & Young, that firm failed to provide complete and thorough advice on matters within its competence and actual knowledge.

The Internal Auditor has probable cause to believe that Ernst & Young -- acting in that same time period as the LAUSD audit firm, accountant of record on the LAUSD financial statements used to issue the 1997 Certificates of Participation, and outside real estate financial expert to Mr. Shambra -- knew or should have known that Belmont's environmental situation posed a clear and present danger to the viability of the economic arrangements contemplated and pursued by the LAUSD to pay for Belmont.

C. Contractors, Consultants, And LAUSD Staff Failed To Provide Proper Oversight Of Expenditures By The Developer, Contractor, And Subcontractors.

1. O'Melveny & Myers LLP Breached Its Duty Of Professional Care To LAUSD.

Mr. David Cartwright, as a partner in the law firm of O'Melveny & Myers LLP, by written memorandum dated December 9, 1998, advised the LAUSD to relax its normal accounting procedures in tracking the expenditures by the developer, contractor and sub-contractors at Belmont. This remarkably ill-conceived advice prompted the Facilities Services Division to unwisely reduce their vigilance in assuring that all costs presented to the LAUSD for payment by the developer, contractor and sub-contractors were proper, accurate and lawful. This advice was relied upon by LAUSD, a fact known to Mr. Cartwright, who knew or should have known that such advice, if relied upon by LAUSD, constituted an invitation to potential waste, fraud and abuse, in a manner ultimately resulting in actual overbilling of LAUSD by certain sub-contractors.

2. The Firms Of Hanscomb, Inc. And Daniel, Mann, Johnson & Mendenhall Failed To Execute Their Duties Faithfully To Protect The LAUSD From Overbilling.

Hanscomb, Inc., and the Daniel, Mann, Johnson & Mendenhall firm were employed expressly by LAUSD to monitor the accuracy and appropriateness of work and expenditures at Belmont, yet they each failed to execute their respective contractual and professional duties to advise LAUSD faithfully on the accuracy and appropriateness of invoices presented to the LAUSD for payment of Belmont expenditures, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

3. Raymond Rodriguez, Elizabeth Louargand And Rodger Friermuth Failed To Execute Their Duties Faithfully To Protect The LAUSD From Overbilling.

In his role at the Office of Planning and Development, Mr. Raymond Rodriguez failed to perform or to cause Hanscomb, Inc., and the Daniel, Mann, Johnson & Mendenhall firm to perform, a review as to the accuracy and appropriateness of invoices presented to the LAUSD for payment of Belmont expenditures, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

In their respective roles in the Facilities Services Division, Ms. Elizabeth Louargand and Rodger Friermuth failed to perform individually or collectively, or individually or collectively to supervise Hanscomb, Inc., and the Daniel, Mann, Johnson & Mendenhall firm to perform, a review as to the accuracy and appropriateness of invoices presented to the LAUSD for payment of Belmont expenditures, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

4 Temple Beaudry Partners Failed To Execute Their Duties Faithfully To Protect The LAUSD From Overbilling.

Temple Beaudry Partners failed to execute their contractual duties under the Disposition and Development Agreement to review invoices, presented to the Temple Beaudry Partners and then forwarded to LAUSD for payment of Belmont expenditures, as to their accuracy and appropriateness, in a manner resulting in actual overbilling of LAUSD by certain sub-contractors.

5. Winegardner Masonry; Rucker Tile; Keenan, Hopkins, S&S; BMP Group; Queen City Glass; and Downey Electric Overbilled The LAUSD For Their Work At Belmont, Implicating The California False Claims Act.

Sub-contractors Winegardner Masonry, Rucker Tile, Keenan, Hopkins, S&S, BMP Group, Queen City Glass, and Downey Electric each submitted repayment requests to LAUSD in which each company knew or should have known the company was overbilling the LAUSD. These overbillings collectively totaled $2,080,148.

II. RECOMMENDATIONS

A. Implement The Recommendations Of The Arthur Andersen, KPMG And Fuller Reports.

The School District should implement the recommendations in the KPMG and Fuller Reports immediately. With regard to the recommendations of fully implementing the Integrated Financial System (IFS), the Superintendent, Chief Operating officer, and Chief Financial Officer should conduct a cost-benefit analysis along with a market survey to determine if it is feasible to continue with this system. Since the inception of the IFS, other technologies and systems have evolved in the public and private sectors, including off-the-shelf accounting systems, which may be modified for LAUSD needs.

The difficulty of making informed decisions is increased when complete and reliable information on LAUSD programs and activities is unavailable. It is also difficult to make fully informed budget decisions when information on actual costs for programs is incorrect or unknown.

Without reliable financial information, LAUSD Board Members do not have the full facts necessary to make investments of scarce resources or direct programs. The lack of reliable financial information also impairs the School Board's ability to adequately fulfill another fundamental obligation to taxpayers – holding LAUSD managers accountable for the way they run LAUSD programs.

B. Encourage A Culture Of Excellence By Tightening LAUSD Accounting Policies And Procedures.

1. Promote A Culture Of Excellence Through Teamwork, Open Communications, And Sharing Of Information.

As disclosed in the first *Report of Findings*, the Internal Auditor again found various LAUSD offices and staff members who practiced a culture of "protect your turf, avoid accountability, and resist change." LAUSD must work every day to change its culture to one of excellence through teamwork, open communications and sharing of information.

2. Make Financial Management A LAUSD-Wide Priority.

Currently, LAUSD's financial data are not always useful, relevant, timely, and reliable enough to use for decision-making. Top management must be totally committed, in both words and actions, to making financial management improvement a LAUSD-wide priority. This commitment includes building a foundation of control and accountability that supports external reporting and performance management, providing clear and strong executive leadership, and using training to change the organizational culture and engage line managers. With existing advances in information technology, the LAUSD's finance function needs to shift from a paper-driven, labor intensive, clerical role to a more consultant-like role as advisor, strategist, analyst, and business partner. LAUSD needs to establish an expectation that the Chief Financial Officer is part of the top management team who provides forward looking analysis that creates a link between accounting information and budget formulation, therby contributing to strategic planning and decision-making.

3. Reconcile Direct Payments To All Outstanding Encumbrances.

The process of using Direct Payments must be reconciled to an outstanding encumbrance to avoid potential waste, fraud and abuse. Direct Payments should be supervised very tightly and used infrequently.

4. Review Invoices Submitted By Contractors and Vendors To Determine If They Have Overbilled LAUSD.

It almost goes without saying that LAUSD should use the strictest of review procedures to review Belmont invoices as they are submitted by any contractor or vendor to determine the accuracy and appropriateness of that invoice prior to payment. Existing checks and balances can be effective if they are followed in the most rigorous manner possible.

5. Investigate All Payments Made To Miscellaneous Vendor Codes.

Miscellaneous vendor codes are a necessary part of any accounting system, but they are a prime opportunity for those with a motive to engage in waste, fraud and abuse. All payments to miscellaneous vendor codes above a threshold amount should automatically be screened carefully for accuracy and appropriateness, and reconciled to an appropriate and applicable budget encumbrance. Miscellaneous vendor codes should never be used in lieu of regular contract code requirements without a clear, written rationale.

C. Hold LAUSD Employees Accountable For Their Performance.

1. Olonzo Woodfin.

The facts as set forth in this *Belmont Report of Findings – Part II*, including Mr. Woodfin's lack of aggressive actions to improve the School LAUSD's financial management practices, procedures and systems, should be considered in the context of his next scheduled performance evaluation.

2. Elizabeth Louargand And Rodger Friermuth.

The facts as set forth in this *Belmont Report of Findings – Part II*, including the failure of Ms. Louargand and Mr. Friermuth, individually and collectively, to supervise carefully the accuracy and appropriateness of actual Belmont expenditures, or to individually and collectively to supervise the outside consultants retained to review the accuracy and appropriateness of actual Belmont expenditures, should be addressed in their current disciplinary proceedings.

D. Revise Certain LAUSD Job Descriptions.

1. Revise The Class Description For Chief Financial Officer.

The LAUSD's Chief Financial Officer should be responsible for not only identifying funding sources and paying obligations, but should also be responsible for (i) managing and controlling LAUSD's financial resources by partnering with LAUSD offices, balancing LAUSD priorities, maintaining effective financial systems, providing reports and analysis, and issuing financial policy and guidance to ensure compliance with laws, statutes and regulations; (ii) assuring continuity of operations by providing accounting, disbursement, asset management, and other quality service to customers; and (iii) providing timely, accurate, consistent, and relevant full-cost executive information for assessing budgetary integrity, operating performance, stewardship, and internal controls which are essential in planning and performing the School LAUSD's mission economically, efficiently, and effectively.

2. Create A Senior Management Position Of "Chief Information Officer."

A Chief Information Officer is critical to building a LAUSD-wide information management capability. A Chief Information Officer serves as a bridge between top management, staff and information management support professionals. This includes focusing and advising senior management on high-value issues, decisions, and investments. Equally vital is taking a strong role in working with the staff to (i) design and manage a LAUSD-wide information technology architecture and (ii) clearly articulate how information management will play a pivotal role in mission improvement. Finally, the Chief Information Officer is usually accountable for serving staff with low-cost, high-quality information technology products and services. Over time, a successful Chief Information Officer evolves from serving only as head of the information management unit to becoming a strategic adviser and architect – a vital member of the top management team. The Chief Information Officer should report directly to the Superintendent.

E. Retain Legal Counsel And Investigate Whether A Civil Action May Be Pursued Against Ernst & Young LLP For Their Breach Of Professional Care Or Duty To The LAUSD.

The LAUSD should examine carefully the role of Ernst & Young with regard to their individual and collective roles, at the same time, of being (1) real estate financial advisor to the LAUSD's Office of Planning and Development; (2) auditor of the LAUSD's finances, and (3) accountant of record for the LAUSD's financial records as reflected in the 1997 Certificates of Participation used to finance Belmont. The Internal Auditor has probable cause to believe that in the first of these roles, Ernst & Young breached its professional duty of care to the LAUSD.

F. Commence Civil Legal Action Against The Law Firm Of O'Melveny & Myers LLP For Their Breach Of Professional Care Or Duty With Regard To Their Role At Belmont On The Issue Of Relaxing Financial Oversight Of The Belmont Developer, Contractor And Sub-Contractors, And Seek Damages And/Or Restitution To The LAUSD.

LAUSD should amend its existing action against O'Melveny & Myers consistent with the findings set forth in this *Belmont Report of Findings – Part II.*

G. Retain Legal Counsel And Investigate Whether A Civil Action May Be Pursued Against Hanscomb, Inc., For Breach Of Professional Care Or Duty With Regard To Their Role At Belmont.

LAUSD must definitively determine, consistent with the findings set forth in this Second Report, whether Hanscomb, Inc., breached its duty of professional care to the LAUSD.

H. Retain Legal Counsel And Investigate Whether A Civil Action May Be Pursued Against Daniel, Mann, Johnson & Mendenhall For Breach Of Professional Care Or Duty With Regard To Their Role At Belmont.

LAUSD must definitively determine, consistent with the findings set forth in this Second Report, whether Daniel, Mann, Johnson & Mendenhall breached its duty of professional care to the LAUSD.

I. Retain Legal Counsel And Commence Civil Legal Actions Against Winegardner Masonry; Rucker Tile; Keenan, Hopkins, S&S; BMP Group; Queen City Glass; And Downey Electric For Violations Of California's False Claims Act, Seeking Both Treble Damages And Civil Penalties.

LAUSD must discourage an atmosphere in which vendors to the LAUSD who have the opportunity and motive to commit waste, fraud or abuse on the LAUSD are able to evade detection, much less serious sanction. LAUSD should, following a complete audit of all payment requests submitted by the contractor and any sub-contractor at Belmont, seek enforcement to the fullest extent of the law against at least the following firms:

- Winegardner Masonry.
- Rucker Tile.
- Keenan, Hopkins, S&S.
- BMP Group.
- Queen City Glass.
- Downey Electric.

LAUSD should seek both treble damages for any overbillings from the inception of their work at Belmont, as well as civil penalties. The enumerated sub-contractors submitted payment requests which collectively totaled $2,080,148.

The Internal Auditor must, for the record, express his astonishment that these companies (and perhaps others), during the pendancy of this very investigation, and notwithstanding the extraordinary controversy surrounding Belmont, would attempt to overbill the LAUSD on Belmont construction. The LAUSD must strike swiftly and forcefully against these actions, for to fail to do so would endanger the LAUSD's financial health and embolden others to commit further waste, fraud and abuse.

J. Request That Dr. Betty Hanson And California Financial Services, Inc., Reimburse The LAUSD Or Provide Compelling Evidence As To Why Such A Reimbursement Is Not Required.

If this request is not handled in a manner satisfactory to the LAUSD, the LAUSD should commence civil legal action against Dr. Betty Hanson and California Financial Services, Inc., to collect the sum of $11,325.

K. Referrals To Prosecutorial Agencies

Based upon the facts available to the Internal Auditor, his attorneys and investigative team, either through documents or personal interviews, the Internal Auditor has probable cause to believe that certain acts or omissions by certain persons or entities may constitute violations of criminal law. As a result, the Internal Auditor has referred these matters to the Los Angeles County District Attorney and the California Attorney General for further investigation and determination, within the respective jurisdictions of those two prosecutorial offices, as to whether a criminal violation(s) has occurred. In light of the constitutional and statutory implications and protections required in criminal investigations, neither the Internal Auditor nor anyone on his legal and investigative teams will comment on any referral to a prosecutorial agency.

RESUMEN EJECUTIVO

Belmont Learning Complex
Informe del Fallo – Parte II

El Auditor Interno presento su primer informe sobre Belmont Learning Complex en Septiembre 14, 1999. En la carta introductoria del Informe del Fallo, el Auditor Interno comento que presentaria un segundo informe sobre los dos temas adicionales que le fueron encomendados, como parte de su investigacion, por la Mesa Directiva Escolar de Los Angeles Unified School District (LAUSD) en Febrero 23, 1999.

- Todos los contratos y pagos a consultores externos y abogados involucrados con Belmont
- Cualquier cuenta controlada por la anterior administracion de Bond and Asset Management/Planning and Development.

Este *Reporte del Fallo sobre Belmont* – Parte II menciona las implicaciones financieras de Belmont, incluyendo una revision de los sistemas de presupuesto y contabilidad de LAUSD utilizados en la situacion de Belmont. *Este Reporte del Fallo – Parte II* completa el informe del Auditor Interno como respuesta a la solicitud hecha por la Mesa Directiva Escolar en Febrero 23, 1999. Los puntos principales del Fallo en este *Reporte del Fallo sobre Belmont – Parte II*, detallados mas adelante, incluyen lo siguiente:

- Ni las Mesas Directivas Escolares de LAUSD, ni los Superintendentes, el Chief Administrative Officer, el Chief Financial Officer, o el Director de la Oficina de Planning and Development de los periodos de 1995-1997 y 1997-1999 cumplieron de manera diligente y colectiva con la supervision en LAUSD (1) solicitar y supervisar un presupuesto real de Belmont, que incluyera las contingencias ambientales y financieras; (2) integrar dicho presupuesto a la estructura global contable de LAUSD; y (3) supervisar los gastos reales de Belmont.

- O'Melveny & Meyers LLP, Ernst & Young LLP, Hanscomb, Inc.,y la firma de Daniel, Mann, Johnson & Mendenhall violaron su obligacion de cuidado profesional con LAUSD en cuanto a los asuntos financieros en los diferentes contratos con LAUSD.

- Dom Shambra, Raymond Rodriguez, Elizabeth Louargand y Rodger Friermuth, Empleados Escolares de LAUSD, no se aseguraron de que las facturas presentadas a LAUSD para pago de los gastos de Belmont fueran precisas y apropiadas, lo que resulto en una sobrefacturacion a LAUSD por parte de algunos consultores y sub-contratistas.

- Temple Beaudry Partners, Hanscomb, Inc., la firma de Daniel, Mann, Johnson & Mendenhall, Raymond Rodriguez, Elizabeth Louargand y Rodger Friermuth; ni uno de ellos se percato de que cada uno de los sub-contratistas de Belmont, Winegardner Masonry, Rucker Tile, Keenan, Hopkins, S&S, BMP Group, Queen City Glass and Downey Electric presento solicitudes de pagos de mas, a LAUSD cuando las companias sabian o deberian haber sabido que la empresa estaba sobre facturando a LAUSD esta sobre facturacion, en conjunto, da un total de $2,080,148.

I. FALLO

A. La Mesa Directiva Escolar de LAUSD y el Senior Staff No le Dieron la Suficiente Prioridad a la Administracion Financiera de 1995-1999.

1. Las Mesas Directivas Escolares de LAUSD de 1995-1997 y de 1997-1999 No le Dieron la Suficiente Prioridad a la Administracion Financiera ni Ejercieron un Supervision Diligente de la Situacion Financiera de Belmont.

La anteriores Mesas Directivas Escolares de LAUSD (particularmente las Mesas Directivas Escolares de 1995-1997 y 1997-1999) no le dieron la sufciente prioridad a los sistemas de administracion financiera de LAUSD. A pesar de que durante el periodo de 1995-1999 hubieron relativos aumentos en dolares al presupuesto disponible de LAUSD, dichas Mesas Directivas Escolares no invirtieron en los mejoras necesarias del Integrated Financial System para hacer que este sistema fuera el adecuado y coherente con la necesidad de LAUSD de mantener unos registros contables, confiables, transparentes y auditables.

La anteriores Mesas Directivas Escolares de LAUSD (particularmente las Mesas Directivas Escolares de 1995-1997 y 1997-1999) no ejercieron una supervision diligente de LAUSD (1) solicitar y supervisar un presupuesto real de Belmont, que incluyera las contingencias ambientales y financieras; (2) integrar dicho presupuesto e la estructura global contable de LAUSD; y (3) supervisar los gastos reales de Belmont.

2. Los Superintendentes Anteriores y Actuales de LAUSD No le Dieron la Suficiente Prioridad a la Administracion Financiera ni Ejercieron un Supervision Diligente de la Situacion Financiera de Belmont.

Sidney A. Thompson, Superintendente de LAUSD durante el verano de 1997, y el Dr. Ruben Zacarias, el actual Superintendente, no realizaron una supervision lo suficientemente diligente de los sistemas administrativos financieros de LAUSD. A pesar de que durante el periodo de 1995 a 1999 hubieron relativos aumentos en dolares al presuesto disponible de LAUSD, dichos Superintendentes no actuaron ante las solicitudes de sus respectivos Chief Financial Officers para invertir en las mejoras necesarias del Integrated Financial System para hacer que este sistema fuera el adecuado y coherente con la necesidad de LAUSD de mantener unos registros contables, confiables, transparentes y auditables.

Ni el Sr. Thompson ni el Dr. Zacarias ejercieron una supervision diligente de LAUSD (1) solicitar y supervisar un presupuesto real de Belmont, que incluyera las contingencias ambientales y financieras; (2) integrar dicho presupuesto e la estructura global contable de LAUSD; y (3) supervisar los gastos reales de Belmont.

3. El Anterior Chief Administrative Officer No Superviso a LAUSD, Para Crear Asi un Sistema Administrativo Financiero Confiable.

El Anterior Chief Administrative Officer, Sr. David Koch, no realizo una supervision lo suficientemente diligente de los sistemas administrativos financieros de LAUSD. A pesar de que durante el periodo de 1995 a 1999 hubieron realtivos aumentos en dolares al presupuesto disponible de LAUSD, no actuo ante las solicitudes de sus respectivos Chief Financial Officers para invertir en las mejoras necesarias del Integrated Financial System para hacer que este sistema fuera el adecuado y coherente con la necesidad de LAUSD de mantener unos registros contables, confiables, transparentes y auditables.

El Sr. Koch tampoco ejercio una supervision diligente de LAUSD (1) solicitar y supervisar un presupuesto real de Belmont, que incluyera las contingencias ambientales y financieras; (2) integrar dicho presupuesto e la estructura global contable de LAUSD; y (3) supervisar los gastos reales de Belmont. En particular, el presupuesto de gastos preparado por el Sr. Koch en Julio 1999, aunque menciona que los calculos son preliminares, omite todo presupuesto de gastos ambientales en Belmont.

De hecho, los gastos de Belmont relacionados con el medio ambiente en ese momento excedieron los $7 millones.

4. Los Chief Financial Officers Anteriores y Actuales No Han Creado ni Mantenido un Sistema Administrativo Financiero Confiable, y No Realizaron Una Supervision Diligente de los Sistemas Administrativos Financieros de LAUSD.

Henry Jones, el anterior Chief Financial Officer, y Olonzo Woodfin, el actual Chief Financial Officer no mantuvieron, en su propia opininon, sistemas administrativos financieros confiables. A pesar de que ambos intenaron obtener los recursos financieros necesarios para corregir la situacion, incluyendo fondos para actualizar el Integrated Financial System automatizado, el funcionamiento actual de varios sistemas financieros contables, tanto automatizados como manuales, no cumplieron (ni individual ni colectivamente) en todo momento con los sistemas contables generalmente aceptados por los estandares contables de las escuelas publicas. La buena fe del actual Chief Financial Officer y su aun asi dificil esfuerzo para responder a la pregunta basica de "en que ha gastado hasta la fecha LAUSD" es una prueba dramatica de la falla de estos sistemas de informacion financiera, los que despues de la auditoria hecha por el Auditor Interno no pueden confirmar los calculos hechos de buena fe por el Chief Financial Officer.

B. La oficina de Planning and Development Personnel le Fallo a LAUSD en Relacion a Belmont.

1. El Sr. Dominic Shambra, Anterior Director de la oficina de Planning and Development de LAUSD, No realizo una Supervision Diligente del Presupuesto y de los Gastos de Belmont.

El Sr. Dominic Shambra, mientras fungio como Director de la oficina de Planning and Development de LAUSD no superviso a los consultores externos y ademas no preparo los registros apropiados que le permitieran a LAUSD mantener unos registros contables generalmente aceptados de los gastos hechos por su oficina. Su comportamiento da lugar a la pregunta de si se hicieron pagos por trabajo no realizado por algunos de estos consultores externos, incluyendo a el Sr. Wayne Wedin y la Dra. Betty Hanson. A pesar de que el Sr. Shambra admitio e informo al LAUSD General Consel que durante el tiempo que ella trabajo para LAUSD desarrollo una relacion personal con la Dra. Betty Hanson, y que sus respectivos puestos de supervisor y subordinada dieron la apariencia de un conflicto de interes , a pesar de que aparentemente, las declaraciones orales del General Counsel estipulan que no existe tal conflicto de interes. Al mismo tiempo, el aparente sobre pago de $11,325 al jefe de la Dra. Hanson, aunado a que el Sr. Wedin no presento los reportes anuales requeridos y a su extremada disponibilidad para trabajar durante los dias festivos, parece que el Sr. Shambras no ejercio la responsabilidad fiduciaria apropiada que le debia a LAUSD en la supervision de su oficina.

El Sr. Shambra tampoco ejercio la responsabilidad fiduciaria apropiada que le debia a LAUSD en la supervision de su oficina al (1) no desarrollar un presupuesto con informacion de contingencia ambiental; (2) no requerir un elemento de contingencia ambiental ya sea en el Disposition and Development Agreement o en los propios libros de LAUSD; y (3) no establecer un base sobre la cual solicitar reembolso por parte del estado y/o por parte de fondos locales de bonos.

El Auditor Interno tiene causa probable para creer que el Sr. Shambra debe cumplir con la maxima responsabilidad como funcionario senior en LAUSD por la actual situacion de Belmont. A pesar del pobre desempeno de sus consultores de desarrollo, eduactivos, legales y financieros, o del pobre desempeno de sus propios supervisores (incluyendo de la Mesa Directiva Escolar) por no cumplir con sus responsabilidades, todos aquellos a quienes contacto el equipo de Auditor Interno, dentro y fuera de LAUSD veian en el Sr. Shambra al guia que haria un exito del proyecto Belmont El Auditor Interno cree que el Sr. Shambra le fallo a los ninōs, al personal y los contribuyentes de LAUSD en su desempeno en relacion a Belmont. Como resultado de esa falla, LAUSD debe tomar acciones para que no se de otro Belmont, y asi evitar que el potencial de desperdicio, fraude y abuso obstruyan la habilidad de LAUSD de prevenirlo.

2. El Sr. Raymond Rodriguez, Anterior Miembro Senior de la Oficina de Planning and Development, No Realizo una Supervision Diligente del Presupuesto y Gastos de Belmont.

El Sr. Raymond Rodriguez, como el mas alto miembro senior despues de Dominic Shambra en la oficina de Planning and Development de LAUSD no coordino las actividades de dicha

Oficina, incluyendo las actividades de los consultores externos, y no preparo los registros apropiados que le permitieran a LAUSD mantener unos registros contables generalmente aceptados de los gastos hechos por su Oficina. Su comportamiento da lugar a la pregunta de si se hicieron pagos por trabajo no realizado por algunos de estos consultores externos, incluyendo a el Sr. Wayne Wedin y la Dra. Betty Hanson

El Sr. Rodriguez tampoco ejercio la responsabilidad fiduciaria apropiada que le debia a LAUSD en la coordinacion de las actividades de esta oficina al (1) no desarrollar un presupuesto con informacion de contingencia ambiental; (2) no requerir un elemento de contingencia ambiental ya sea en el Disposition and Development Agreement o en los propios libros de LAUSD; y (3) no establecer una base sobre la cual solicitar reembolso por parte del estado y/o por parte de fondos locales de bonos.

3. Dra. Betty Hanson y California Financial Services Sobre Facturaron a LAUSD Por $11,325.

El Auditor Interno tiene causa probable para creer que la Dra. Betty Hanson y/o California Financial Services, Inc. sobre facturaron a LAUSD por $11,325.

4. El Sr. Wayne Wedin no Documento su Trabajo Adecuadamente.

El Auditor Interno tiene causa probable para creer que el Sr. Wayne Wedin, mientras fue consultor de la oficina de Planning and Development, no propociono los informes requeridos, ni por actividad ni anualmente, como lo requiere LAUSD, y no dio una descripcion lo suficientemente clara de su trabajo para justificar los pagos que recibio de LAUSD, aunque cuyo pago fue aprobado for el Sr. Domininc Shambra.

5. Ernst & Young Violo su Responsabilidad de Cuidado Profesional con LAUSD

El Auditor Interno tiene causa probable para creer que Ernst & Young, a pesar de que fueron contratados por LAUSD y se confio en ellos como expertos, sobretodo en la oficina de Planning and Development, no identificaron ni sugirieron estrategias para evitar riesgos financieros o alguna accion correctiva en relacion a las implicaciones financieras sobre el asunto de remediacion ambiental (ya fuese por medio de una reserva de contingencia a traves del Development and Disposition Agreement o por medio de una reserva de contingencia en el propio presupesto de LAUSD, o a traves del uso de un seguro ambiental) por lo tanto no cumplio con su responsabilidad profesional con LAUSD. Aun cuando el Sr. Shambra, El Sr. Wedin y la Dra. Hanson asi como otras personas en LAUSD confiaron en ellos, la firma de Ernst & Young no proporciono informacion completa y detallada en asuntos de su competencia y conocimiento.

El Auditor Interno tiene causa probable para creer que Ernst & Young –fungiendo durante el mismo periodo como firma auditora de LAUSD, responsable de los registros de los estados financieros de LAUSD utilizados para emitir los Certificates of Participation en 1997, y experto financiero, externo, en bienes raices al servicio del Sr. Shambra -- sabia o debia haber sabido que la situacion ambiental de Belmont representaba un peligro claro y real para la viabilidad de los arreglos economicos contemplados y perseguidos por LAUSD para pagar Belmont.

C. Contratistas, Consultores y Personal de LAUSD no Advirtieron Sobre Los Gastos que Realizaron El Desarrollador, El Contratista y los Sub-contratistas.

1. O'Melveny & Meyers LLP Violo Su Responsabilidad de Cuidado con LAUSD.

El Sr. David Cartwright, como socio del despacho de abogados O'Melveny & Myers LLP, aconsejo por medio de un memorandum fechado Diciembre 9, 1998, a LAUSD que aligerara sus procedimientos normales para hacer seguimiento de los gastos hechos por el desarrollador, por el contratista y sub-contratistas en Belmont. Este consejo notablemente mal concebido hizo que Facilities Services Division redujera indebidamente la vigilancia que tenia para asegurar que todos los costos presentados a LAUSD para pago por parte del desarrollador, de los contratistas y sub-contratistas fueran apropiados, correctos y legales. LAUSD confio en este consejo, bien sabido por el Sr. Cartwright, quien sabia o debaria de haber sabido que dicho consejo, si LAUSD confiaba en el, constituia una invitacion potencial para el desperdicio, fraude y abuso, lo que de alguna manera dio como resultado la sobre facturacion a LAUSD por parte de algunos sub-contartistas.

2. Las Firmas de Hanscomb, Inc. y Daniel, Mann, Johnson & Mendehall no Llevaron a Cabo su Tarea de Proteger Fielmente a LAUSD de Sobre Facturacion.

Hasncomb, Inc., y la firma Daniel, Mann, Johnson & Mendehall fue contratada por LAUSD expresamente para monitorear que el trabajo y los gastos en Belmont fueran certeros y apropiados, sin embargo ninguno cumplio con su responsabilidad contractual y profesional de informar a LAUSD fielmente si las facturas presentadas a LAUSD para pago de los gastos de Belmont eran correctas y apropiadas, lo que de alguna manera dio como resultado la sobre facturacon a LAUSD por parte de algunos sub-contratistas.

3. Raymond Rodriguez, Elizabeth Lourgand y Rodger Friermuth no Llevaron a Cabo su Tarea de Proteger Fielmente a LAUSD de Sobre Facturacion.

Dentro de su funcion en la oficina de Planning and Development, el Sr. Raymond Rodriguez no llevo a cabo u ocasiono que Hanscomb, Inc., y la firma de Daniel Mann, Johnson and Mendehall no llevaran a cabo, una revision y asi asegurarse de que las facturas presentadas a LAUSD para pago de los gastos de Belmont eran correctas y apropiadas, lo que de alguna manera dio como resultado la sobre facturacion a LAUSD por parte de algunos sub-contratistas.

Ni la Srita. Elizabeth Lougrand ni el Sr. Rodger Friermuth dentro de sus respectivas funciones en Facilities Services Division realizaron una revision de manera individual o colectiva, ni supervisaron de manera individual o colectiva a Hanscomb, Inc., y a la firma de Daniel Mann, Johnson y Mendehall para que llevaran a cabo una revision y asi asegurarse de que las facturas presentadas a LAUSD para pago de los gastos de Belmont eran correctas y apropiadas, lo que de alguna manera dio como resultado la sobre facturacion a LAUSD por parte de algunos sub-contratistas.

4. Temple Beaudry Partners no Llevo a Cabo su Tarea de Proteger Fielmente a LAUSD de Sobre Facturacion.

Temple Beaudry Partners no cumplio con su responsabilidad como parte de su obligacion contractual bajo el Disposition and Development Agreement de revisar las facturas presentadas a Temple Beaudry Partners y que despues se enviaron a LAUSD para pago de los gastos de Belmont y asi asegurarse de que eran correctas y apropiadas, lo que de alguna manera dio como resultado la sobre facturacion a LAUSD por parte de algunos sub-contratistas.

5. Winegardner Masonry; Rucker Tile; Keenan, Hopkins, S&S; BMP Group; Queen City Glass; and Downey Electric Sobre facturaron a LAUSD Por su Trabajo en Belmont, Implicando al California False Claims Act.

Cada Uno de los sub-contratistas Winegardner Masonry, Rucker Tile, Keenan, Hopkins, S&S, BMP Group, Queen City Glass and Downey Electric presentaron solicitudes de pago de mas a LAUSD en las cuales cada compania sabia o deberia de haber sabido que estaba sobre facturando a LAUSD. Estas sobre facturaciones de manera colectiva dieron un total de $2,080,148 ***por una sola solicitud de pago.***

II. RECOMENDACIONES

A. Implementar Las Recomendaciones de los Informes de Arthur Andersen, KMPG y Fuller.

El Distrito escolar debe implementar inmediatamente, las recomendaciones presentadas en los Reportes de KMPG Y Fuller. Con respecto a las recomendaciones de implementar en su totalidad el Integrated Financial System (IFS), el Superintendente, el Chief Operating Officer y el Chief Financial Officer deben llevar a cabo un analisis de costo-beneficio junto con un estudio de mercado para determinar si es conveniente continuar con este sistema. Desde el inicio del IFS, se han desarrollado otras tecnologias y sistemas dentro de los sectores publico y privado, incluyendo sistemas de contabilidad que se pueden adquirir facilmente, y que se pueden modificar de acuerdo a las necesidades de LAUSD.

La dificultad de tomar decisiones informadas aumenta cuando no se cuenta con la informacion completa y confiable sobre los programas y actividades de LAUSD. Tambien es dificil tomar decisiones bien informadas sobre presupuesto cuando la informacion sobre costos reales para programas es incorrecta o se desconoce.

Sin una informacion financiera confiable, los Miembros de la Mesa Directiva de LAUSD no cuentan con todos los hechos necesarios para invertir recursos escasos o programas directos. La falta de informacion financiera confiable tambien le impide a la Mesa Directiva Escolar de LAUSD satisfacer adecuadamente otra obligacion fundamental con los contribuyentes – responsabilizar a los administradores de LAUSD por la manera en que llevan a cabo los programas de LAUSD.

B. Promover una Cultura de Excelencia Reforzando las Politicas Contables y Procedimientos de LAUSD.

1. Promover una Cultura de Excelencia a Traves del Trabajo en Equipo, Comunicaciones Abiertas y Compartiendo Informacion.

Como se informo en el primer *Reporte del Fallo*, el Auditor Interno volvio a a encontrar varias oficinas y personal de LAUSD que practicaron una cultura de "protege tu cesped, evita responsabilidad, y resite al cambio." LAUSD debe trabajar cada dia para cambiar su cultura por una de excelencia a taves del trabajo de equipo, comunicaciones abiertas y compratiendo informacion.

2. Hacer que la Administracion Financiera sea una Amplia Prioridad de LAUSD

Actualmente, la informacion financiera de LAUSD no siempre resulta de utilidad, relevante, puntual y confiable. La gerencia alta debe estar completamente comprometida, tanto de palabra como de accion, para hacer que las mejoras en la administracion financiera sean una amplia prioridad en LAUSD. Este compromiso incluye el construir unos cimientos de control y responsabilidad que apoye el informe externo y una administracion de desempeno, proporcionando un liderazgo ejecutivo claro y fuerte y utilizando la capacitacion para cambiar la cultura organizacional y crear gerentes en linea. Con los avances existentes en la informacion tecnologica, la funcion financiera de LAUSD necesita cambiar su actitud de oficina de papeleo y labor intensa, a una actitud de tipo consultor-consejero, estratega, analista y socio de negocio. LAUSD necesita crear una expectativa de que el Chief Financial Officer es parte del equipo de la gerencia alta y que proporcione un deseo de analisis, que cree un lazo entre la informacion contable y la formulacion de un presupuesto, para asi contribuir a una planeacion estrategica y de toma de decision.

3. Conciliar Pagos Directos con Todos los Cargos.

El procedimiento de utilizar Pago Directo se debe conciliar con cualquier cargo pendiente para evitar posible desperdicio, fraude y abuso. Los Pagos Directos se deben supervisar muy estrictamente y no se deben utilizar con frecuencia.

4. Revisar Las Facturas Presentadas por los Contratistas y los Proveedores para Determinar si se ha sobre facturado a LAUSD.

Practicamente se da por entendido que LAUSD debe de utilizar los procedimientos de revision mas estrictos para revisar las facturas de Belmont conforme las presente cualquier contratista o proveedor para determinar si son correctas y apropiadas antes de realizar el pago correspondiente. El sistema de cheques y balances existente puede ser efectivo si se hace un seguimiento sumamente riguroso del mismo.

5. Investigar Todos los Pagos Hechos a los Codigos de Proveedores Miscelaneos.

Los codigos de proveedores miscelaneos son una parte fundamental de cualquier sistema de contabilidad, pero son una excelente oportunidad para aquellos que tienen un motivo para realizar un desperdicio, fraude o abuso. Todos los pagos hechos a los codigos de próveedores miscelaneos que excedan el limite establecido deben revisarse muy cuidadosamente para asi asegurarse de que sean correctos y apropiados, y conciliarse con un cargo apropiado y aplicable dentro del presupuesto. Nunca se deben utilizar los codigos de proveedores miscelaneos *in lieu* de requerimientos de codigos de contratos regulares sin un racional claro y por escrito.

C. Responsabilizar a los Empleados de LAUSD Por Su Desempeno.

1. Olonzo Woodfin.

Los hechos como se estipulan en este *Informe del Fallo de Belmont – Parte II*, incluyendo la falta de acciones agresivas por parte del Sr. Woodwin para mejorar las practicas adminstrativas financieras de la Escuela de LAUSD, procedimientos y sistemas, deben de tomarse en cuenta en su proxima evaluacion de desempeno programada.

2. Elizabeth Louargand y Roger Friermuth.

Los hechos como se estipulan en este *Informe del Fallo de Belmont – Parte II*, incluyendo la falta individual y colectiva, por parte de la Srita. Louargand y del el Sr. Friermouth, de supervisar cuidadosamente que los gastos de Belmont fueran correctos y apropiados, o de bien supervisar individual o colectivamente a los consejeros externos que fueron contratados para revisar cuidadosamente que los gastos de Belmont fueran correctos y apropiados, deben de mencionarse en sus procesos actuales diciplinarios.

D. Revisar Ciertos Descripciones de Puesto de LAUSD.

1. Revisar la Descripcion de Nivel del Chief Financial Officer.

El Chief Financial Officer de LAUSD deber ser responsible no solo por identificar recursos para fondos y por pago de obligaciones, sino tambien debe ser responsable por (i) administrar y controlar los recursos financieros trabajando en conjunto con las oficinas de LAUSD, nivelar las prioridades de LAUSD, mantener sistemas financieros efectivos, proporcionar informes y analisis, y emitir politicas y guias financieras para asegurarse de que se concuerde con leyes, estautos y reglamentos; (ii) asegurar una continuidad de las operaciones proporcionando contabilidad, gastos, administracion de bienes, y otros servicios de calidad a los clientes; y (iii) proporcionar informacion ejecutiva completa, puntual, consistente y relevante para estudiar la integridad presupuestal , desarrollo operativo, gerencia y controles internos que son escenciales en la planeacion y en el desempeno de la mision Escolar de LAUSD de una manera economica, eficiente y efectiva.

2. Crear un Puesto de Senior Management del "Chief Information Officer."

El tener un Chief Information Officer es sumamente importante para crear una amplia capacidad de administracion de informacion en todo LAUSD. Un Chief Information Officer sirve como puente entre la gerencia alta, el personal y los profesionales de apoyo de la administracion de informacion. Esto incluye el enfocarse en, e informar a la gerencia senior sobre asuntos de alta importancia, decisiones e inversiones. Igualmente vital es el tomar una actitud firme para trabajar con el personal (i) disenar y administrar una arquitectura de informacion tecnologica en todo LAUSD (ii) expresar claramente como es que la administracion de la informacion juega un papel primordial en la mejora del objetivo. Finalmente, el Chief Information Officer es normalmente responsable de porporcionar productos y servicios de informacion tecnologica de alta calidad y bajo costo al personal. Con el tiempo, un Chief Information Officer con exito comienza su desarrollo sirviendo solo como cabeza de la unidad de administracion de informacion para convertirse en un arquitectoy consejero estratega – un miembro vital del equipo de la gerencia alta. El Chief Information Officer deber reportar directamente al Superintendente.

E. Contratar Asistencia Legal e Investigar si se Puede Tomar Accion Legal en Contra de Ernst & Young LLP Por Haber violado su Cuidado Profesional o su Obligacion Para con LAUSD.

LAUSD debe examinar cuidadosamente el papel de Ernst & Young con respecto a sus funciones individuales y colectivas, al servir al mismo tiempo de (1) consejero financiero de bienes raices de la oficina de Planning and Developmnet de LAUSD; (2) auditor de las finanzas de LAUSD, y (3) responsable de los registros de los informes financieros de LAUSD tal como se reflejaron en los Certificates of Participation de 1997 utilizados para financiar Belmont. El Auditor Interno tiene causa probable para creer que en la primera de estas funciones, Ernst & Young violo su responsabilidad de cuidado profesional con LAUSD.

F. Iniciar Accion Legal en Contra de la Firma O'Melveny & Myers LLP Por Violar su Responsabilidad o Tarea de Cuidado con Respecto a su Papel en Belmont en el Asunto de Aligerar la Revision Financiera del Desarrollador de Belmont, el Contratista y Sub-contratistas, y Perseguir Danos y/o Restitucion a LAUSD.

LAUSD debe corregir su accion existente en contra de O'Melveny & Myers para que concuerde con los fallos establecidos en este *Informe del Fallo de Belmont – Parte II.*

G. Contratar Asistencia Legal e Investigar si se Puede Tomar Accion Legal en Contra de Hanscomb, Inc., Por Haber violado su Cuidado Profesional o su Obligacion en relacion a su funcion en Belmont.

LAUSD debe determinar definitivamente, de acuerdo con los fallos establecidos en este Segundo Informe, si Hanscomb Inc., violo su responsabilidad de cuidado profesional con LAUSD.

H. Contratar Asistencia Legal e Investigar si se Puede Tomar Accion Legal en Contra de Daniel, Mann, Johnson & Mendenhall Por Haber violado su Cuidado Profesional o su Obligacion en relacion a su funcion en Belmont.

LAUSD debe determinar definitivamente, de acuerdo con los fallos establecidos en este Segundo Informe, si Daniel, Mann, Johnson & Mendenhall violo su responsabilidad de cuidado profesional con LAUSD.

I. Contratar Asistencia Legal e Iniciar Accion Legal en Contra de Winegardner Masonry; Rucker Tile; Keenen; Hopkins, S&S; BMP Group; Queen City Glass; y Downey Electric Por Violaciones a la California False Claims Act, Danos Triples y Sanciones Civiles.

LAUSD debe desmotivar cualquier atmosfera en la que los proveedores de LAUSD que tienen la oportunidad y el motivo para realizar desperdicio, fraude o abuso en LAUSD puedan evadir ser detectados, y sobre todo una sancion severa. LAUSD debe, despues de una auditoria completa de todas las solicitudes de pago que presentaron los contratistas y cualquier sub-contratista en Belmont, perseguir legalmente hasta el maximo posible a por lo menos las siguientes firmas:

- Winegardner Masonry
- Rucker Tile
- Keenen; Hopkins, S&S
- BMP Group
- Queen City Glass
- Downey Electric

LAUSD debe perseguir danos triples por cualquier spobre facturacion desde el inicio de su trabajo en Belmont, asi como sanciones penales. Los sub-contratistas mencionados presentaron solicitudes de pago que colectivamente dieron un total de $2,080,148.

El Auditor Interno, debe expresar, para el record, su sorpresa de que estas companias (y quizas otras), mientras se llevaba a cabo esta investigacion, y a pesar de la extraordinaria controversia en relacion a Belmont, intentaran sobre facturar a LAUSD por la construccion de Belmont. LAUSD debe perseguir rapida y determinantemente estas acciones, ya que el no hacerlo pondria en peligro la salud financiera de LAUSD e invitaria otros a cometer mas desperdicio, fraude y abuso.

J. Solicitar que la Dra. Betty Hanson y California Financial Servies, Inc., Reembolsen a LAUSD o Proporcione Evidencia de Peso de Porque no es Necesario Dicho Reembolso.

Si no se atiende a esta solicitud de manera satisfactoria para LAUSD, LAUSD debe iniciar accion legal en contra de la Dra. Betty Hanson y Calfornia Financial Services,Inc., para cobrar la suma de $11,325.

K. Referencias a Agencias Acusadoras.

Basandose en los hechos a los que tuvo acceso el Auditor Interno, sus abogados y equipo de investigacion, ya sea por medio de documentos o de entrevistas personales, el Auditor Interno tiene causa probable para creer que ciertos actos u omisiones por parte de algunas personas o entidades podrian constituir violaciones de la ley penal. Como resultado, el Auditor Interno ha referido estos asuntos a Los Angeles County District Attorney y al California Attorney General para una investigacion posterior y determinacion, dentro de las jurisdicciones respectivas de esas dos agencias acusadoras, de si ha ocurrido una (s) violacion (es) penal (es). Como resultadode las implicaciones constitucionales y estatutarias y protecciones requeridas en investigaciones criminales, ni el Auditor Interno ni nadie de su equipo legal, hara comentario alguno sobre las referncias a agencias acusadoras.

Glossary of Parties

LAUSD Personnel

Sidney Thompson	Superintendent (1994 to 1997)
Reuben Zacarias	Superintendent (1997 to Present)
Richard Mason	General Counsel (1994 to Present)
Henry Jones	Chief Financial Officer (1996 to 1997)
Olonzo Woodfin	Controller (1996-1998) Chief Financial Officer (1999 to present)
Ray Rodriguez	Admin. Coordinator, Planning and Development, Facilities (1995 to 1998)
Dominic Shambra (Retired)	Director, Planning & Development (1993 to 1998)
Roger Friermuth	Facilities Project Manager II (1997 to 1999)
Beth Louargand	Director, Facilities Division (1995 to Present)
Doug Brown	Director, Facilities Division (1991 to 1994)
Dr. Bonnie James	Director Facilities
Yoshi Fong	Director of Accounting (1997 to 1998) Acting Controller (1998 to 1999)
Howard Kaplowitz	Head Accountant (1996 to Present)
Karen Hemingway	Accounts Payable Section
Thais Rothman	Contracts Unit
Fred Lising	Director of Accounting, Gen. Acct Branch (1997 to 1998)
Marty Varon	Budget Director (1999)

LAUSD CONSULTANTS

California Financial Services
Daniel, Mann Johnson & Mendenhall
Ernst & Young LLP (Kenneth Leventhal)
Hanscomb, Inc.
Wedin Enterprises

Former Outside Counsel

David Cartwright James Colbert Ed Szczepkowski	O'Melveny & Meyers 1999 Avenue of the Stars, Suite 700 Los Angeles, CA 90067

DEVELOPER

Temple Beaudry Partners, LLC
Kajima Urban Development LLC (Managing Partner)
The Legaspi Company
Gateway Science & Engineering
Regent Partners, Inc.

Legal Counsel to Temple Beaudry Partners LLC
Latham & Watkins

Architect
McLarand, Vasquez & Partners, Inc.

CONSTRUCTION

Turner/Kajima Joint Venture
Turner Construction Company
Kajima Construction Services

BMP Group
Cast-in-place concrete

SELECTED SUB-CONTRACTORS

Downey Electric, Inc.
Electrical wiring

Keenan, Hopkins, S&S
Drywall/E.I.F.S. contractor

Queen City Glass
Glass and window installation

Rucker Tile
Ceramic tile

Winegardner Masonry
Cast-in-place concrete

LIST OF ACRONYMS

ACRONYM	DEFINITION
Belmont	Belmont Learning Complex
BFAT	Budget, Finance, Audit and Technology Committee
BPAU	Budget Planning and Analysis Unit
CEQA	California Environmental Quality Act
COP	Certificate of Participation
DDA	Disposition and Development Agreement
DMJM	Daniel, Mann, Johnson & Mendenhall
ENA	Exclusive Negotiation Agreement
FCA	California False Claims Act
GASB	Governmental Accounting Standards Board
GMP	Guaranteed Maximum Price
IFS	Integrated Financial Systems
LAUSD	Los Angeles Unified School District
OMM	O'Melveny & Myers
PICK	Stand alone accounting system
PMCB	Project Management and Construction Branch
SAB	State Allocation Board
SACS	Standardized Accounting Code Structure
SFPO	Strategic Financial Planning Office
TBP	Temple Beaudry Partners

EXHIBITS 1 - 72

EXHIBIT INDEX

EXHIBIT NO.	DOCUMENT DESCRIPTION
1	Memorandum to Don Mullinax from Olonzo Woodfin regarding Documents for Belmont Learning Complex Briefing, dated October 11, 1999.
2	Memorandum to Lisa Robins and Kelly Todd from Jacinta Holley regarding Response to Audit Request for Accounting Data, dated October 29, 1999.
3	Budget Manual, Pages 50 and 51.
4	Los Angeles Unified School District, Outstanding Encumbrances for the PO's dated between 1993-07-01 and 1998-10-30.
5	Working documents regarding California Financial Services improperly overpaid on contract CS950378.
6	GASB Codification Section 1700.129.
7	Los Angeles Unified School District, Budget Services and Financial Planning Division Bulletin No. 36, dated May 19, 1995.
8	Summerford working documents, dated November 1999.
9	Excerpts from the Contract Handbook, dated September 1996.
10	Letter to Michael Scinto from Cheryl L. Allen regarding Belmont Senior High School Number 1, Office of Public School Construction No. 22/64733-11-31, dated March 21, 1995.
11	Letter to ABB Environmental Services, Inc. from S. Thais Rothman regarding Amendment to Agreement #910087, dated October 17, 1990.
12	Proskauer Rose LLP Invoice file # 47715.0002, dated March 29, 1999.
13	Memorandum to Mei Ginn from Mike DeLuca regarding Condemnation Actions-Payment to O'Melveny & Myers-July 1, 1994 through June 30, 1995-Transmittal Dated November 14, 1995 from Richard K. Mason, General Counsel, dated December 19, 1995.
14	Memorandum to Al Southwood from J. Michael DeLuca regarding Eminent Domain Invoices-O'Melveny & Myers, dated December 5, 1994.
15	Memorandum to Fred Lising from Howard Kaplowitz regarding Year-End Budget Override, dated May 8, 1998.

EXHIBIT INDEX

EXHIBIT NO.	DOCUMENT DESCRIPTION
16	Los Angeles Unified School District Contract Payment Certificate, dated August 25, 1999.
17	Memorandum to Howard Kaplowitz from Richard Mason regarding Condemnation Actions-Payment o the Law Firm of O'Melveny & Myers, dated November 14, 1995.
18	District Voucher Copy Warrant No. 20172261, dated August 15, 1997.
19	Invoice for Payment Services Rendered Under Personal or Professional Services Contract (Form CS004) relating to Community Partners, signed on August 7, 1997.
20	Invoice to Los Angeles Unified School District, attention: Richard Lui from Remedial Management Corporation, dated December 24, 1997.
21	Work Authorization No. 3, signed by Beth Louargand, effective May 4, 1999.
22	California Financial Services contract #950378.
23	Law Crandall contract #965201. Letter from Barbara Rachal to Richard C. Leach of Law Crandall, dated March 19, 1996, and invoices for environmental services for contract #965201.
24	Outline for Mitigation of Site and Disbursal of Funds, undated.
25	Letter to Richard Lui from Richard Spivak of Duke Engineering regarding Belmont Learning Complex request for Additional Funds, dated November 6, 1997.
26	Letter to Frank Harding, Office of Local Assistance, from Janice Sawyer, Environmental Health and Safety Branch regarding Belmont New Middle School No. 1-Project No. 22/64733-11-23 Oil Well Abandonment Monitor, dated April 6, 1994.
27	Memorandum to the Board of Education of the City of Los Angeles from Superintendent of Schools regarding Selection of Development Team for Exclusive Negotiations-Belmont Learning Complex-Joint Venture Project, dated August 7, 1995.
28	Record of Work Activities for Contract with California Financial Services and Los Angeles Unified School District (invoice) and approved for payment by Dom Shambra, dated December 1995.

EXHIBIT INDEX

EXHIBIT NO.	DOCUMENT DESCRIPTION
29	Los Angeles Unified School District Payroll Calendar 1995-96.
30	Invoice to Dominic Shambra from Wayne D. Wedin regarding Invoice for Consulting Service – April 1987 Agreement #870493, dated May 6, 1987.
31	Invoice to Dominic Shambra from Wayne D. Wedin regarding Invoice for Consulting Services – March 1991 Asset Management-Contract #910904, dated April 16, 1991.
32	Memorandum to Thais Rothman from Richard K. Mason regarding Contract No. 921077, Wedin Enterprises, Inc., dated October 6, 1993; and Memorandum to Elaine Denny from Wayne Wedin, dated October 18, 1993.
33	Memorandum to Thais Rothman from Richard Mason regarding Renewal of Wayne Wedin Contract, dated November 18, 1993.
34	Memorandum to Fred Lising from Richard Mason regarding Payment to Wayne Wedin for Professional Services, dated January 26, 1994.
35	Memorandum to Fred Lising from Richard K. Mason regarding Payment to Wayne Wedin for Professional Services, dated January 26, 1994.
36	Memorandum to Fred Lising from Thais Rothman regarding $75,000 Amendment to Agreement #930535 with Wedin Enterprises, Inc., dated March 1, 1994.
37	Memorandum to Rich Mason from Thais Rothman regarding IFS encumbrance of $75,000 Amendment to Agreement #930535 with Wedin Enterprises, Inc., dated March 16, 1994.
38	Handwritten note showing a date of August 25, 1995.
39	Memorandum to Howard Kaplowitz from Dominic Shambra regarding Payment to Wedin Enterprises, Inc. for Services Rendered Regarding the Belmont Learning Complex, dated September 27, 1995.
40	Memorandum to Henry Jones from Dominic Shambra regarding Request to Increase Funding for Professional Contact regarding Temple-Beaudry Project/Belmont Learning Complex, dated January 29, 1996.
41	Invoice No. 010396 to Dominic Shambra from Wedin Enterprises regarding Invoice for Consulting Services-December 1995, dated January 7, 1996.

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EXHIBIT NO.	DOCUMENT DESCRIPTION
42	Invoice No. 030296 to Dominic Shambra from Wedin Enterprises regarding Invoice for Consulting Services-February 1996, dated March 5, 1996.
43	Invoice No. 060296 to Dominic Shambra from Wedin Enterprises regarding Invoice for Consulting Services-May 1996, dated June 4, 1996.
44	Invoice No. 070296 to Dominic Shambra from Wedin Enterprises regarding Invoice for Consulting Services-June 1996, dated June 28, 1996.
45	Memorandum to Richard Mason from S. Thais Rothman regarding Agreement No. 960124 with Wedin Enterprises, Inc.-is an Additional Board Report Needed to Authorize an Amendment Exceeding $100,000, dated June 14, 1996.
46	Memorandum to Howard Kaplowitz from Dominic Shambra regarding Invoice for Payment of Services Rendered Under Professional Services Contract, dated August 14, 1996 with attached Wedin invoice #080296 and memorandum dated August 19, 1996 with attached Wedin invoice #090296.
47	Memorandum to Rich Mason from Wayne Wedin regarding Contract, dated October 12, 1996; and Memorandum to Sidney Thompson from Richard Mason regarding Contracts with Wedin Enterprises, Inc., dated October 17, 1996; with attached documents (Bates stamped numbers IA-00332 through IA-00336).
48	Memorandum to Howard Kaplowitz from Dominic Shambra regarding Invoice for Payment of Services Rendered Under Professional Services Contract [Various Projects], dated August 10, 1997 with attached Wedin invoice #0601297 and memorandum, dated August 10, 1997, with attached Wedin invoice #0601297A.
49	Finance Organization Charts From 1996 to 2000
50	Letter to Ken Reizes Kajima Urban Development from Raymond Rodriguez Project Coordinator regarding Notification that the District has retained Daniel, Mann, Johnson and Mendenhall to provide Owners Representative Services for the Belmont Learning Complex, dated October 8, 1997.
51	Letter to Beth Louargand G.M. Facilities Service, L.A. City Board of Ed. From David Chua ARICS Vice President regarding Belmont Learning Complex Payment Schedule of Value, dated December 31, 1997.
52	Letter to Beth Louargand G.M. Facilities Service, L.A. City Board of Ed. from Gregory Kobzeff Project Manager regarding Project Status Report #12 January 1999, dated February 19, 1998.

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EXHIBIT NO.	DOCUMENT DESCRIPTION
53	Letter to Beth Louargand G.M. Facilities Service, L.A. City Board of Ed. from Gregory Kobzeff Project Manager regarding Project Status Report #13 February 1999, dated March 9, 1999.
54	Letter to Julie Korenstein, President LAUSD Board from Tom Hayden regarding concern at the prospect of Daniel, Mann, Johnson and Mendenhall of oversight management of the Belmont Learning Complex, dated July 30, 1997.
55	Inter Office Correspondence to Ruben Zacarias from Beth Louargand regarding Construction Manager for Belmont Learning Complex, dated August 19, 1997.
56	Letter to Dom Shambra from Steve Valenzuela regarding 50% Design Development Budget, dated December 11, 1996.
57	Memorandum to Steve Valenzuela from David Bentley regarding Belmont Learning Center, dated December 2, 1996.
58	Memorandum to Steve Valenzuela from David Bentley regarding Ernst & Young's Response to Turner's Letter of 2/21/97 Regarding their Proposed GMP, dated March 5, 1997.
59	Letter to Kenneth Reizes from David Bentley regarding Belmont Learning Complex: GMP Review, dated 3March 10, 1997.
60	WRAP-UP '97 regarding Market Review & Forecast for Controlled Insurance Programs
61	Memorandum to Edward Blakely and Roger Rasmussen from Dominic Shambra regarding Oversight Committee Meeting – April 2, 1997, dated March 26, 1997.
62	Memorandum to Steve Valenzuela from David Bentley regarding Belmont Learning Center, dated December 10, 1996.
63	Report of the Executive Officer, State Allocation Board Meeting, June 25, 1997.
64	Memorandum to Ruben Zacarias and Howard Miller from Olonzo Woodfin regarding Los Angeles Times Article regarding Belmont Learning Complex Certificates of Participation (COPs), dated December 10, 1999.
65	Memorandum to Sidney A. Thompson from Henry Jones regarding Belmont Learning Complex – School Financing Analysis, dated August 28, 1996.

EXHIBIT INDEX

EXHIBIT NO.	DOCUMENT DESCRIPTION
66	Memorandum to Ruben Zacarias from Henry Jones regarding $91,400,000 Los Angeles Unified School District Variable Rate Certificates of Participation (COPs) (Belmont Learning Complex) 1997 Series A, dated December 9, 1997.
67	Memorandum to Maruch Atienza from Yoshi Fong, regarding Belmont Learning Complex Budget Adjustment, dated April 21, 1998.
68	Memorandum to Ray Rodriguez from Henry Jones, regarding Retail for Belmont Learning Complex, dated May 29, 1998.
69	Memorandum to Ray Rodriguez from Henry Jones, regarding Belmont Learning Complex – Retail Component, dated June 16, 1998.
70	Excerpts of the Disposition and Development Agreement (DDA).
71	California Financial Services: From Betty Hanson V.P. of Educational Services to Dominic Shambra Director of Planning and Development regarding obtaining funds from the FEMA dated March 16, 1995.
72	Memorandum to Ray Rodriguez from David Cartwright regarding Belmont Accounting and Payment Practices Under the DDA (520,000-511), dated December 9, 1998.